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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936 1937

No. 29

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

ANNIE M. PFEIFFER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 15, 1937

CERTIORARI GRANTED MAY 17, 1937

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 895

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

ANNIE M. PFEIFFER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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Before United States Board of Tax Appeals

Docket No. 82616

ANNIE M. PFEIFFER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket entries

Appearances:

For Taxpayer: Robert A. Young, Esq., Warren W. Grimes, Esq., M. Ward Whalen, Esq., Roger S. Baldwin, Esq.

For Commissioner: Hartford Allen, Esq.

1936

Jan. 4—Petition received and filed. Taxpayer notified. (Fee paid.)

Jan. 6—Copy of petition served on General Counsel.

Feb. 3—Amended petition filed by taxpayer. February 4, 1936, copy served.

Feb. 10—Answer to amended petition and original petition filed by General Counsel.

Feb. 12—Copy of answer served on taxpayer.

Mar. 17—Notice of the appearance of Warren W. Grimes, counsel for taxpayer.

Mar. 26—Notice of the appearance of M. Ward Whalen, counsel for taxpayer.

Apr. 4—Motion to place on Washington Day Calendar April 20, 1936, filed by taxpayer. April 6, 1936, granted.

Apr. 6—Hearing set April 20, 1936.

Apr. 20—Hearing had before Mr. J. E. Murdock, Division 3. Submitted on the merits. Stipulation of facts filed and respondent's Memorandum of Authority. Petitioner's brief due May 11, 1936; five days for reply.

2 Apr. 24—Transcript of hearing April 20, 1936, filed.

May 11—Brief filed by taxpayer (2). Copy served on General Counsel.

May 26—Motion for leave to file Supplemental Brief (Supplemental Brief attached), filed by taxpayer. May 26, 1936, granted. May 29, 1936, copy served on General Counsel.

May 26—Supplemental Brief filed by taxpayer.

June 27—Memorandum Opinion rendered. Mr. J. E. Murdock, Division 3, Decision will be entered under Rule 50.

July 10—Notice of appearance of Roger S. Baldwin as counsel.

July 13—Motion for decision under Rule 50 filed by General Counsel.

July 16—Hearing set August 5, 1936, under Rule 50.

July 18—Consent to settlement filed by taxpayer.
July 22—Decision entered, Mr. J. E. Murdock, Division 3.
July 25—Motion to fix amount of bond at $130,000, filed by taxpayer. July 25, 1936, granted.
July 31—Supersedeas Bond in the amount of $130,000, approved and ordered filed.
July 31—Power of attorney and agreement filed.
Aug. 7—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
Aug. 7—Proof of service filed by taxpayer.
Aug. 7—Praecipe filed with proof of service thereon.

Before United States Board of Tax Appeals

[Title omitted.]

Amended petition

Filed Feb. 3, 1936

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated December 12, 1935, bearing the following symbols: IT:AR:A-5:WGS-90D, and as a basis of her proceeding, alleges as follows:

1. The petitioner is an individual residing at No. 370 Riverside Drive, New York, New York.

2. The notice of deficiency, a copy of which is attached and marked "Exhibit A", was mailed to the petitioner on December 12, 1935.

3. The taxes in controversy are Federal income taxes for the calendar year 1931 in the amount of $125,660.67.

4. The determination of tax set forth in the said notice of deficiency and the subject of this petition is based upon the following errors:

(a) Respondent erred in determining that the issuance during the year 1931 by William R. Warner Corporation to petitioner of 6,291¼ shares of preferred stock of said Corporation as a dividend upon the common stock of said Corporation then owned by petitioner, did not constitute a tax free stock dividend, and that the sum of $629,125, representing the fair market value of said shares of preferred stock, constituted income of petitioner subject to taxation.

Said determination so made by respondent was and is erroneous for the following reasons, among others:

(1) The issuance of said 6,291¼ shares of preferred stock to petitioner by said William R. Warner Corporation constituted a stock dividend within the meaning of Section 115 (f) of the Revenue Act of 1928 and was not and is not subject to tax.

(2) The issuance of said 6,291¼ shares of preferred stock to petitioner by said William R. Warner Corporation was not a distribution

by said corporation in money or other property out of its earnings or profits accumulated after February 28, 1913, within the meaning of Section 115 (a) of the Revenue Act of 1928.

(3) The receipt by petitioner of said 6,291¼ shares of preferred stock of William R. Warner Corporation did not constitute income within the meaning of the 16th Amendment to the Constitution of the United States and therefore each and every provision of the Revenue Act of 1928 which imposed or purported to impose a
5 tax against the petitioner based on the fair market value of said shares of preferred stock, was and is in violation of the provisions of Article I, Section 2, Clause 3, and of Article I, Section 9, Clause 4, of the Constitution of the United States, in that the Revenue Act of 1928 does not apportion the tax thereby imposed among the several states according to their respective numbers or in proportion to the census or enumeration directed to be taken by said Constitution; and was and is in violation of the provisions of the 5th Amendment to the Constitution which provides, in part, that no person shall be deprived of his property without due process of law.

(b) The respondent further erred in determining that the issuance during the year 1931 by William R. Warner Corporation to the petitioner of said 6,291¼ shares of preferred stock of said Corporation was taxable, for the reason, among other reasons, that the distribution by William R. Warner Corporation of said 6,291¼ shares of preferred stock of said Corporation during the year 1931, and the receipt thereof by the petitioner, was a distribution in pursuance of a plan of reorganization within the meaning of the provisions of Section 112 of the Revenue Act of 1928.

(c) The respondent erred in determining that the sum of $200,000, the proceeds from the sale by petitioner to William R. Warner Corporation of 2,000 shares of preferred stock of said Corporation, was taxable as a dividend under the provisions of Section 115 (g) of the Revenue Act of 1928.

6 The Commissioner erred for the following reasons, among others:

The proceeds of such sale were not essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g) of the Revenue Act of 1928.

The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) William R. Warner Corporation (hereinafter referred to as "Warner Corporation") is a corporation organized in the year 1920 under the laws of the State of Delaware. The original authorized capital stock of the Warner Corporation was $2,300,000, consisting of 3,000 shares of common stock of the par value of $100 per share ($300,000) and 20,000 shares of preferred stock of the par value of $100 per share ($2,000,000). All of such authorized stock was issued for cash or property.

(b) During the period from the time of its incorporation to January 1, 1928, the Warner Corporation, by means of successive amendments to its articles of incorporation, duly increased its authorized capital stock from the original capital of $2,300,000 to $15,000,000, consisting of 100,000 shares of common stock of the par value of $100 per share ($10,000,000) and 50,000 shares of preferred stock of the par value of $100 per share ($5,000,000).

(c) Of the authorized increase in common stock, amounting to $9,700,000, all was issued as a dividend on the common stock of the Corporation—$7,000,000 on or about December 19, 1922,
7 $700,000 on or about December 22, 1923, and $2,000,000 on or about June 12, 1925. Of the authorized increase in preferred stock, amounting to $3,000,000, there was issued as a dividend on the common stock of the Corporation—$1,000,000 on or about June 12, 1925, and $1,000,000, on or about December 31, 1926.

(d) During the year 1928, the Warner Corporation was again duly recapitalized, in accordance with the laws of the State of Delaware, by increasing its authorized capital stock from $15,000,000 to $25,000,000, consisting of 100,000 shares of common stock of the par value of $100 per share ($10,000,000) and 150,000 shares of preferred stock of the par value of $100 per share ($15,000,000).

(e) During the year 1928, the directors of said Warner Corporation duly authorized the issuance and distribution of 50,000 shares of said additional 100,000 shares of preferred stock resulting from said recapitalization as a stock dividend to the holders of record of the common stock of said Corporation in the ratio of one share of preferred stock to two shares of common stock. Thereafter, and during the year 1928, the officers of said Corporation, pursuant to the authority so given by the directors, duly issued 50,000 shares of preferred stock of said Corporation in the ratio of one share of preferred stock to two shares of common stock to the common stockholders of record at the close of business on December 1, 1928.

That your petitioner was the owner and holder of record on
8 December 1, 1928, of 25,165 shares of common stock of said Corporation and received 12,582½ shares of said preferred stock as a stock dividend and pursuant to said distribution.

(f) At the beginning of the year 1931, there remained unissued 50,000 shares of said preferred stock which said Warner Corporation had obtained authority to issue by virtue of the recapitalization which occurred during the year 1928.

(g) During the year 1931, the directors of said Warner Corporation duly authorized the issuance of 25,000 shares of said preferred stock as a stock dividend to holders of record of the common stock of said Corporation in the ratio of one share of preferred stock to four shares of common stock. Thereafter and during the

year 1931, the officers of said Corporation, pursuant to the authority so given by the directors, duly issued and distributed 25,000 shares of preferred stock of said Corporation in the ratio of one share of preferred stock to four shares of common stock to the common stockholders of record at the close of business on April 2, 1931. That your petitioner was the owner and holder of record on April 2, 1931, of 25,165 shares of the common stock of said Corporation and received 6,291¼ shares of such preferred stock as a stock dividend and pursuant to such distribution.

(h) On information and belief, the distribution by William R. Warner Corporation of said 6,291¼ shares of preferred stock of said Corporation during the year 1931, and the receipt
9 thereof by the petitioner, was not only in fact and in law a non-taxable stock dividend, but also was a distribution in pursuance of a plan of reorganization within the meaning of the provisions of Section 112 of the Revenue Act of 1928.

(i) During the year 1931 your petitioner sold to the Warner Corporation 2,000 shares of the preferred stock of said Corporation which she then owned and which she had acquired as a part of the stock dividend and distribution of 12,582½ shares during the year 1928, as aforesaid, and received therefor the sum of $200,000.

(j) Petitioner included in her return for the year 1931 the sum of $180,100 as capital gain from the sale of said 2,000 shares of preferred stock sold to the Warner Corporation during the year 1931 and paid the capital gain tax thereon in the amount of $22,512.50, no part of which tax has been refunded or allowed as a credit.

WHEREFORE, the petitioner prays that this Board may hear this proceeding and relieve the petitioner from the deficiency in tax resulting (1) from treating the fair market value of said 6,291¼ shares of preferred stock received by the petitioner in the year 1931 as a taxable dividend; (2) from treating the proceeds of the sale of said 2,000 shares of preferred stock received by the petitioner in the year 1928 as a taxable dividend for the year 1931; and (3) in the event that a deficiency in tax shall be found by reason of treating the said 6,291¼ shares of preferred stock as a taxable dividend, that the amount of such deficiency shall be reduced
10 by the elimination of the capital gain tax on the said 2,000 shares of preferred stock sold to the Warner Corporation in the year 1931.

ANNIE M. PFEIFFER,
Petitioner.

ROBERT A. YOUNG,
Counsel for Petitioner,
Office and P. O. Address,
No. 120 Broadway, New York, New York.

[*Duly sworn to by Annie M. Pfeiffer, jurat omitted in printing.*]

11 *Exhibit A to amended petition*

IT:AR:A-5
WGS-90D

DEC. 12, 1935.

MRS. ANNIE M. PFEIFFER,
370 Riverside Drive,
New York, New York.

MADAM: You are advised that the determination of your income tax liability for the year 1931, discloses a deficiency of $125,660.67, as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1928, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period
12 terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By (Signed) CHAS. T. RUSSELL,
Deputy Commissioner.

Enclosures:
Statement
Form 870
Schedules 1 and 2 WGS/MQ-3

STATEMENT

IT:AR:A-5
WGS-90D

In re: Mrs. Annie M. Pfeiffer, 370 Riverside Drive, New York, New York

Income Tax Liability

Year	Income tax liability	Income tax assessed	Deficiency
1931	$183,016.19	$57,355.52	$125,660.67

Adjustments producing the above-stated results are shown in the attached schedules.

Careful consideration has been accorded your protest dated May 9, 1935, against the findings contained in Bureau letter dated April 19, 1935.

A copy of this letter, together with a copy of the statement and schedules has been mailed to your representative, Mr. Robert A. Young, 120 Broadway, New York, New York, in accordance
13 with the authority conferred upon him in the power of attorney executed by you and on file with the Bureau.

WGS/MQ-3

Mrs. Annie M. Pfeiffer

Year ended December 31, 1931

SCHEDULE 1. *Adjustments to net income*

Net income as disclosed by return:		
Ordinary	$215,915.11	
Capital	180,100.00	$396,015.11
As corrected		956,780.95
Net adjustment as computed below		$560,765.84
Unallowable deductions and additional income:		
(a) Preferred stock redeemed	$200,000.00	
(b) Dividend in preferred stock	629,125.00	
Total		$829,125.00
Nontaxable income and additional deductions:		
(c) Capital gain	$180,100.00	
(d) Contributions	88,259.16	
Total		$268,359.16
Net adjustment as above		$560,765.84

14 SCHEDULE 1-A. *Explanation of items*

(a) and (c) The amount received upon the redemption of 2,000 shares of preferred stock held by you in the William R. Warner Corporation is considered a taxable dividend under the provisions of section 115 (g) of the Revenue Act of 1928, upon a review of the facts submitted with respect to the issuance of stock dividends and their subsequent redemption by the corporation, and accordingly is included herein as taxable income, in lieu of the capital gain reported upon the sale of such stock.

(b) It is held that the issuance during the year 1931, by the William R. Warner Corporation of preferred stock as a dividend upon the common stock, did not constitute a tax-free stock dividend and, accordingly, the value thereof is taxable to the recipient. The declaration of this dividend effected an alteration of preexisting interests of the stockholders.

(d) Adjustment of allowance for donations under the statutory limitation is computed as follows:

Net income reported (as above)	$396,015.11
Add:	
Contributions deducted	69,885.02
Additions, items (a) and (b)	829,125.00
	$1,295,025.13
Deduct:	
Item (c) above	180,100.00
15 Net income before deduction of contributions	$1,114,925.13
15% limitation	167,238.77
Actual contributions (allowed)	158,144.18
Deducted on return	69,885.02
Additional allowance	88,259.16

WGS/MQ-3

Mrs. Annie M. Pfeiffer

Year ended December 31, 1931

SCHEDULE 2. *Computation of tax*

Net income (subject to surtax)		$956,780.95
Less:		
Dividends	$1,126,290.60	
Interest on Liberty bonds	2,762.50	
		1,129,053.10
Balance subject to normal tax		None
Surtax on $956,780.95		183,016.19
Total		183,016.19
Tax previously assessed Acct. No. 301382		57,355.52
Additional tax to be assessed		125,660.67

WGS/MQ-3

16 Before United States Board of Tax Appeals

[Title omitted.]

Answer to original and amended petitions

Filed February 10, 1936

Now comes the Commissioner of Internal Revenue, by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for answer to the original and amended petitions in the above-entitled proceeding, admits and denies as follows:

1. Admits the allegations of paragraph 1 of the original and amended petitions.

2. Admits the allegations of paragraph 2 of the original and amended petitions.

3. Admits the allegations of paragraph 3 of the original and amended petitions.

4. (a). (1–3), (b), and (c). Denies the allegations of paragraphs 4 (a) (1) to (3), (b) and (c), inclusive, of the original and amended petitions, and further, denies that in the determination of the tax liability for the year 1931, the respondent erred in the manner alleged.

17 Page 4 (a) to (j). Denies any knowledge or information sufficient to form a belief as to the truth of the allegations of paragraphs (a) to (j), inclusive, appearing on pages 4, 5, 6, and 7 of the original and amended petitions and therefore, denies the same.

6. Denies generally and specifically each and every allegation of the original and amended petitions not hereinabove admitted or denied.

Wherefore, it is prayed that the petition be denied.

Herman Oliphant,
(Signed) HERMAN OLIPHANT,
General Counsel for the Department of the Treasury.

Of Counsel:
HARTFORD ALLEN,
WALTER W. KERR,
Special Attorneys,
Bureau of Internal Revenue.

A/mms—2/7/36.

18 Before United States Board of Tax Appeals

[Title omitted.]

Agreed statement of facts

Filed April 20, 1936

It is hereby stipulated and agreed by and between the counsel for each party that the following facts may be taken as true for the purposes of the trial of this proceeding, subject to the right of either party to introduce additional evidence upon such trial and subject to the right of either party to object to the relevancy or materiality of any item of evidence herein contained:

1. Petitioner is an individual residing at No. 370 Riverside Drive, New York, New York.

2. Petitioner filed an individual Federal income tax return for the year 1931 in the office of the Collector of Internal Revenue, New York, New York (3d District), and reported therein a net taxable income in the amount of $396,015.11, of which $215,915.11 was reported as ordinary income, and of which the balance of $180,100 was reported as capital gain. Such return disclosed a total tax liability of $57,355.52, which was paid.

19 3. Under date of December 12, 1935, the Respondent issued a 90-day letter in accordance with the provisions of Section 272 (a) of the Revenue Act of 1928, as amended by Section 501 of the Revenue Act of 1934, proposing the assessment of a deficiency against the Petitioner for the year 1931 in the amount of $125,660.67. The proposed additional tax of $125,660.67 is due to the following adjustments in the Petitioner's net income:

(1) The inclusion of $629,125.00, the par value of the preferred stock of William R. Warner Corporation, received by the Petitioner during the year 1931 as a pro rata distribution to common stockholders, as a taxable dividend.

(2) The inclusion of $200,000.00 representing the proceeds from the redemption by the William R. Warner Corporation during the year 1931 of 2,000 shares of preferred stock of that Corporation received by the Petitioner during the year 1928 (Certificates Nos. 3455 and 3456 for 1,000 shares each) as a part of her pro rata distribution of preferred stock to common stockholders, as a taxable dividend under the provisions of Section 115 (g) of the Revenue Act of 1928.

A copy of the 90-day letter is attached hereto, designated as Schedule No. 1, and made a part of this Agreed Statement of Facts.

4. William R. Warner Corporation is a corporation duly organized on November 8, 1920, under the laws of the State of Dela-
20 ware under the name of "William R. Warner & Co., Inc." for the primary purpose of taking over the business of a Pennsylvania corporation of the same name, organized in 1908, and acquiring and holding the stocks of various subsidiary or affiliated companies. The details of the acquisition of the assets and properties, including the capital stock of other companies, of the Pennsylvania corporation are not deemed material to the determination of the questions involved in the instant controversy. The principal office of the Delaware Corporation is at No. 113 West 18th Street, New York, New York. The name of the Delaware Corporation was changed from William R. Warner & Co., Inc., to William R. Warner Corporation, on August 5, 1930, and on August 7, 1934, was again changed to William R. Warner & Co., Inc.

5. The original authorized capital stock of the Delaware Corporation was $2,300,000, consisting of 20,000 shares of preferred stock of the par value of $100 per share, amounting in the aggregate to $2,000,000 and 3,000 shares of common stock of the par value of $100 per share, amounting in the aggregate to $300,000. Article FOURTH of the original Certificate of Incorporation, relating to the preferences and priorities of the preferred and common stocks, is attached hereto, designated as Schedule No. 2.

6. Under the terms of the agreement between the Delaware Corporation and the Pennsylvania corporation whereby the Delaware Corporation acquired all of the assets and properties of the Pennsylvania corporation, the Delaware Corporation agreed to issue
21 to the Pennsylvania corporation, or its nominees, all of its authorized common stock (3,000 shares) and 2,000 shares of its preferred stock. The Pennsylvania corporation directed the Dela-

ware Corporation to issue the common and preferred stock to its shareholders in the same proportion as their stock holdings in the Pennsylvania corporation. This stock was so issued as follows:

Name	Common Stock	Preferred Stock
Annie M. Pfeiffer	600	-----
Gustavus Pfeiffer	1,185	-----
Henry Pfeiffer	855	-----
Garfield D. Merner	300	-----
Other persons	60	-----
William R. Warner, Jr.	-----	2,000
	3,000	2,000

Shortly after the Delaware corporation was organized, it issued the following preferred shares to the persons indicated in settlement of an indebtedness of the Pennsylvania corporation to those persons which had been assumed by the Delaware corporation:

Name	Number of Shares
Annie M. Pfeiffer	1,368
Gustavus Pfeiffer	2,702
Henry Pfeiffer	1,950
Other persons	823
	6,843

7. During the period from November 8, 1920, to December
22 31, 1921, Petitioner became the owner of 155 additional shares of the common stock of the Delaware corporation. The Petitioner acquired 125 of said additional shares as a gift from her husband, Henry Pfeiffer, and purchased the remaining shares for cash.

Hereinafter, it will be understood that the Delaware Corporation will be referred to as the "Corporation."

8. On or about December 20, 1922, the Certificate of Incorporation of the Corporation was amended so as to increase the authorized capital stock from $2,300,000, consisting of preferred stock of the par value of $2,000,000, and common stock of the par value of $300,000, to the sum of $10,000,000, consisting of 20,000 shares of preferred stock of the par value of $100 per share, amounting in the aggregate to $2,000,000, and 80,000 shares of common stock of the par value of $100 per share, amounting in the aggregate to $8,000,000, an increase of $7,700,000 in the common stock. The terms, provisions, preferences and priorities of the two classes of stock remained unchanged.

9. On December 22, 1922, pursuant to authority of the Board of Directors, the Corporation issued and distributed 70,000 shares of common stock amounting in the aggregate in par value to $7,000,000, pro rata to common stockholders of the Corporation.

A copy of the minutes of the meeting of the Board of Directors of the Corporation held on December 22, 1922, at which the Board authorized the said distribution is annexed hereto, designated as Schedule No. 3.

23 At that time, the outstanding capital stock of the Corporation was held as follows:

Name of Shareholder	Common Stock	Preferred Stock
Annie M. Pfeiffer	755	2,370
Gustavus Pfeiffer	1,485	------
Henry Pfeiffer	730	50
C. Leonard Pfeiffer	30	30
Employees of Corporation		2,191
Other Shareholders		11,013
	3,000	15,654

Petitioner was the owner of 755 shares of the common stock of the Corporation and received as her pro rata share of such distribution 17,616 shares of common stock, thereby increasing the number of common shares then owned by her to 18,371. (Fractional shares are disregarded.)

10. On December 20, 1923, pursuant to authority of the Board of Directors, the Corporation issued and distributed the remaining 7,000 shares of common stock amounting in the aggregate in par value to $700,000, pro rata to common stockholders.

A copy of the minutes of the meeting of the Board of Directors of the Corporation held on December 5, 1923, at which the Board authorized the said distribution, is annexed hereto, designated as Schedule No. 4.

At that time, the outstanding capital stock of the Corporation was held as follows:

24 Name of Shareholder	Common Stock	Preferred Stock
Annie M. Pfeiffer	18,371	1,475
Gustavus Pfeiffer	36,135	------
Henry Pfeiffer	17,764	8
C. Leonard Pfeiffer	730	130
Employees of Corporation		2,663
Other Shareholders		11,733
	73,000	16,009

Petitioner was the owner of 18,371 shares of the common stock and received as her pro rata share of such distribution 1,761 shares of common stock, thereby increasing the number of common shares then owned by her to 20,132.

11. On April 22, 1925, pursuant to an authorization adopted at a special meeting of the preferred and common stockholders of the Corporation, the Certificate of Incorporation was again amended so as to increase the authorized capital stock from $10,000,000, consisting of $2,000,000 of preferred stock and $8,000,000 of common stock, to $15,000,000, consisting of 50,000 shares of preferred stock of the par value of $100 per share, amounting in the aggregate to $5,000,000 and 100,000 shares of common stock of the par value of $100 per share, amounting in the aggregate to $10,000,000; an increase of $3,000,000 in the preferred stock and of $2,000,000 in the common stock.

All the common stock, including the common stock of the Petitioner, was voted in person or by proxy in favor of said increase in authorized capital stock.

25 The terms, provisions, preferences, and priorities of the two classes of stock remained unchanged.

A certificate reflecting this increase in capital was duly filed in the office of the Secretary of State of Delaware on April 22, 1925.

12. On July 22, 1925, pursuant to authority of the Board of Directors, as set forth in Schedule No. 5, the Corporation issued and distributed 20,000 shares of common stock, amounting in the aggregate in par value to $2,000,000, pro rata to common stockholders, and at the same time distributed 10,000 shares of preferred stock, amounting in the aggregate in par value to $1,000,000, pro rata to common stockholders of the Corporation.

A copy of the minutes of the meeting of the Board of Directors of the Corporation held on June 12, 1925, at which the Board authorized the said distribution, is annexed hereto, designated as Schedule No. 5.

At that time, the outstanding capital stock of the Corporation was held as follows:

	Common Stock	Preferred Stock
Annie M. Pfeiffer	20,132	1,410
Gustavus Pfeiffer	39,600	------
Henry Pfeiffer	19,468	------
C. Leonard Pfeiffer	800	30
Employees of Corporation	------	2,858
Other Shareholders	------	11,201
	80,000	15,499

26 Petitioner was the owner of 20,132 shares of common stock and received as her pro rata share of such distribution 5,033 shares of common stock and 2,516 shares of preferred stock.

13. On December 31, 1926, pursuant to the authorization of the Board of Directors, the Corporation issued and distributed 10,000 shares of the preferred stock of the Corporation, amounting in the aggregate in par value to $1,000,000, pro rata, to common stockholders of the Corporation in the ratio of one (1) share of preferred stock to each ten (10) shares of common stock.

A copy of the minutes of the meeting of the Board of Directors of the Corporation held on November 30, 1926, at which the Board authorized the said distribution, is annexed hereto, designated as Schedule No. 6.

At that time, the outstanding capital stock of the Corporation was held as follows:

Name of Shareholder	Common Stock	Preferred Stock
Annie M. Pfeiffer	25,165	3,676
Gustavus Pfeiffer	49,500	1,995
Henry Pfeiffer	24,335	1,847
C. Leonard Pfeiffer	1,000	170
Employees of Corporation	------	3,259
Other Shareholders	------	12,655
	100,000	23,602

Petitioner was the owner of 25,165 shares of common stock of the Corporation and received as her pro rata share of such distribution 2,516 shares of preferred stock.

27 14. On November 28, 1928, pursuant to an authorization adopted at a special meeting of the preferred and common stockholders of the Corporation, the Certificate of Incorporation was again amended so as to increase the authorized capital stock from $15,000,000, consisting of $5,000,000 of preferred stock and $10,000,000 of common stock, to $25,000,000, consisting of 150,000 shares of preferred stock of the par value of $100 per share, amounting in the aggregate to $15,000,000, and 100,000 shares of common stock of the par value of $100 per share, amounting in the aggregate to $10,000,000, an increase of $10,000,000 in the preferred stock.

99,000 out of 100,000 shares of the common stock of the Corporation, including all of the stock of the Petitioner, was voted in person or by proxy in favor of the said increase in authorized capital stock.

A copy of the minutes of the meeting of the shareholders of the Corporation held on November 27, 1928, at which the shareholders authorized the said increase in the authorized capital stock, is annexed hereto, designated as Schedule No. 7.

The terms, provisions, preferences, and priorities of the two classes of stock remained unchanged.

A certificate reflecting this increase in capital was duly filed in the office of the Secretary of State of Delaware on November 28, 1928.

15. On December 31, 1928, pursuant to authority of the Board of Directors, the Corporation issued and distributed 50,000 shares

28 of the preferred stock of the Corporation, amounting in the aggregate in par value to $5,000,000, pro rata to common stockholders of the Corporation in the ratio of one (1) share of preferred stock to each two (2) shares of common stock held by the common stockholders.

A copy of the minutes of the meeting of the Board of Directors of the Corporation held on December 18, 1928, at which the Board authorized the said distribution, is annexed hereto, designated as Schedule No. 8.

At that time, the outstanding capital stock of the Corporation was held as follows:

Name of shareholder	*Common Stock*	*Preferred Stock*
Annie M. Pfeiffer	25,165	12,122
Gustavus Pfeiffer	49,500	5,895
Henry Pfeiffer	24,335	79
C. Leonard Pfeiffer	1,000	270
Employees of Corporation	-------	4,355
Other Shareholders	-------	21,583
	100,000	34,304

Petitioner was the owner of 25,165 shares of common stock and received as her pro rata share of such distribution 12,582 shares of preferred stock of the Corporation.

16. On April 27, 1931, pursuant to authority of the Board of Directors of the Corporation, the Corporation issued and distributed

25,000 shares of the preferred stock of the Corporation, of the value of $100 per share, amounting in the aggregate to $2,500,000, pro rata to common stockholders of the Corporation in the ratio of one (1) share of preferred stock to each four (4) shares of common stock.

A copy of the minutes of the meeting of the Board of Directors of the Corporation held on April 24, 1931, at which the Board authorized the said distribution, is annexed hereto, designated as Schedule No. 9.

At that time, the outstanding capital stock of the Corporation was held as follows:

Name of Shareholder	Common Stock	Preferred Stock
Annie M. Pfeiffer	25,165	9,642
Gustavus A. Pfeiffer	49,500	24,034
Henry Pfeiffer	24,335	6,901
C. Leonard Pfeiffer	1,000	150
Employees of Corporation	-------	5,836
Other Shareholders	-------	32,977
	100,000	79,540

Petitioner was the owner of 25,165 shares of common stock and received as her pro rata share of such distribution 6,291¼ shares of preferred stock of the Corporation.

17. The following tabulation shows (1) the original capitalization of the Corporation, (2) each change in the authorized capital stock, and (3) each distribution of common and preferred stock made to the common stockholders from the date of organization to and including April 27, 1931. Each distribution of preferred and common stock set forth below was made pro rata to the holders of the common stock.

Date	Common stock		Preferred stock	
	Authorized	Issued	Authorized	Issued
Nov. 8, 1920, original issue	$300,000	$300,000	$2,000,000	$2,000,000
Dec. 20, 1922, increase	7,700,000	-------	-------	-------
Dec. 22, 1922, distributed	-------	7,000,000	-------	-------
Dec. 20, 1923, distributed	-------	700,000	-------	-------
Apr. 22, 1925, increase	2,000,000	-------	3,000,000	-------
July 22, 1925, distributed	-------	2,000,000	-------	1,000,000
Dec. 31, 1926, distributed	-------	-------	-------	1,000,000
Nov. 28, 1928, increase	-------	-------	10,000,000	-------
Dec. 31, 1928, distributed	-------	-------	-------	5,000,000
Apr. 27, 1931, distributed	-------	-------	-------	2,500,000
Total	$10,000,000	$10,000,000	$15,000,000	$11,500,000

NOTE (1). The above table does not show the outstanding preferred stock.
NOTE (2).—The above table does not include the transaction involving the redemption of the preferred stock in 1931.

All of the distributions of preferred and common stock, including the distribution of April 27, 1931, consisted of new stock not previously issued, and represented a capitalization of earnings and profits accumulated since the Corporation was formed in November 1920.

18. After the distribution of the stock dividends in 1928 and 1931, the Corporation continued to engage in business under the same directors, officers and management, the same as it had been doing prior to those respective dates.

19. There is attached hereto and made a part of this Agreed Statement of Facts a schedule, designated as Schedule No. 10, showing the Consolidated Balance Sheets of the Corporation and its Subsidiaries as of (1) January 1, 1921 (2) January 1, 1929, (3) January 1, 1931, and (4) December 31, 1931, and an analysis of
31 the consolidated surplus for the year ended December 31, 1931.

20. There is attached hereto and made a part of this Agreed Statement of Facts a schedule, designated as Schedule No. 11, showing the Balance Sheets of William R. Warner Corporation as of the following dates: (1) January 1, 1921, (2) January 1, 1929, (3) January 1, 1931, and (4) December 31, 1931; and an analysis of surplus for the year ended December 31, 1931.

21. The Consolidated Net Earnings of the Corporation and its Subsidiaries, after the deduction for taxes, for the years 1920 to 1931, inclusive, are shown in the annexed schedule, designated as Schedule No. 12.

The term "Subsidiaries", as used in this Agreed Statement of Facts, means corporations all of whose capital stock, except a very small amount of preferred stock of two or three subsidiary corporations, was owned by the Corporation.

22. The net earnings of the Corporation, including dividends of its Subsidiaries, for the years 1920 to 1931, inclusive, after the deduction for taxes, are also shown on the annexed Schedule No. 12.

23. Schedule No. 12 also contains a statement of the cash dividends distributed by the Corporation on its common and preferred stocks during each of the years 1920 to 1931, inclusive. There has been no default in the payment of dividends in full on the outstanding
32 preferred stock of the Corporation since its organization, and at the time of the distribution of the 25,000 shares of preferred stock of the Corporation referred to in paragraph 16 of this Agreed Statement of Facts, distributed on April 27, 1931, there was no accumulation of unpaid dividends on any of the preferred stock of this Corporation.

24. The shares of preferred stock of the Corporation distributed to Petitioner in the years 1928 and 1931 had, at the time of receipt by Petitioner, the fair market value of $100 per share.

Petitioner did not include as gross income in her Federal income-tax return for the year 1928 the value of the 12,582 shares of preferred stock of the Corporation received by her as a stock dividend during that year.

25. On December 29, 1931, the Corporation redeemed 8,500 shares of its preferred stock, of which 2,000 shares were owned by Petitioner and represented stock which she had acquired as a part of the said 12,582 shares of preferred stock distributed to her as a stock

dividend during the year 1928. Of the balance of the shares so redeemed, Gustavus A. Pfeiffer owned 4,500 shares and Henry Pfeiffer owned 2,000 shares. Gustavus A. Pfeiffer and Henry Pfeiffer were the remaining principal common stockholders of the Corporation.

26. Upon the transfer of the said 2,000 shares of preferred stock to the Corporation, the Petitioner received therefor the sum of $200,000 in cash.

33 27. Petitioner included in her Federal income tax return for the year 1931, and designated as capital gain, the sum of $180,100 representing gain from the redemption by the Corporation of said 2,000 shares of preferred stock, computed in accordance with the regulations of the Respondent governing the ascertainment of the basis of stock received as a stock dividend, and the sum of $200,000 received therefor. Petitioner paid an income tax of $22,512.50 thereon, such tax being computed at the capital gain tax rate.

28. If the Board should find that the redemption of said 2,000 shares of preferred stock constituted a sale and that the gain is required to be computed on the adjusted cost basis, then it is conceded that the gain thereon amounted to $180,100 and that the proper amount of tax has been paid thereon.

29. If the Petitioner's net income is reduced by the order of the Board, the statutory limitation of the deductions for charitable contributions may be adjusted accordingly.

Dated: April 15, 1936.

ROBERT A. YOUNG,
Attorney for Petitioner.
HERMAN OLIPHANT,
Attorney for Respondents.

(For Schedule No. 1 referred to herein see Exhibit A attached to Amended Petition.)

34 *Schedule No. 2*

William R. Warner & Co., Inc.

Certificate of Incorporation

Article Fourth

The total authorized capital stock of the Corporation is twenty thousand (20,000) shares of Preferred Stock of the par value of One Hundred Dollars ($100) per share amounting in the aggregate to Two Million Dollars ($2,000,000), and three thousand (3,000) shares of Common Stock of the par value of One Hundred Dollars ($100) per share amounting in the aggregate to Three Hundred Thousand Dollars ($300,000).

The said twenty thousand (20,000) shares of Preferred Stock shall be entitled to receive, when and as declared, from the surplus

or net profits of the Company, yearly dividends at the rate of six percentum (6%) per annum and no more, payable quarterly on the first week-day of October, January, April, and July beginning in January 1921. The dividends on the Preferred Stock shall be cumulative and shall be payable before any dividend on the Common Stock shall be paid or set apart, so that if in any year dividends amounting to six percent (6%) shall not have been paid thereon, the deficiency shall be payable before any dividend shall be paid upon or set apart for the Common Stock. Whenever all cumulative dividends on the Preferred Stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly installments for the current year shall have
35 been declared and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the Board of Directors may declare dividends on the Common Stock payable then or thereafter, out of any remaining surplus or net profits. In the event of any liquidation or dissolution or winding up of the corporation (whether voluntary or involuntary) the holders of the Preferred Stock shall be entitled to be paid in full, both the par amount of their shares and the unpaid dividends accrued thereon before any amount shall be paid to the holders of the Common Stock. Thereafter the remaining assets and funds shall be divided and paid to the holders of the Common Stock, according to their respective shares. The holders of the Preferred Stock shall not be entitled to vote. Such Preferred Stock shall be redeemable by the company or may be purchased by it on any quarterly dividend day in amounts of not less than one hundred (100) shares at the price of One Hundred and Five Dollars ($105) per share, together with all unpaid dividends accrued thereon.

Schedule No. 3

William R. Warner & Co., Inc.

Special Meeting of Board of Directors

A Special Meeting of the Board of Directors of William
36 R. Warner & Co., Inc., was held at the office of the Company, No. 113 West 18th Street, Borough of Manhattan, City, County, and State of New York, on the 22nd day of December 1922, at 2:30 o'clock, P. M.

There were present at said meeting: Messrs. Henry Pfeiffer, Gustavus A. Pfeiffer, Ernest B. Benson, Edward Kallenbach.

Absent: Mr. William R. Warner, Jr.

The President of the Company, Mr. Henry Pfeiffer, presided, and called the meeting to order, and Mr. E. B. Benson, the secretary of the Company, acted as Secretary of the Meeting.

The Secretary presented an agreement and written Waiver of Notice, signed by all of the Directors, which was ordered to be placed on file.

On motion duly made, seconded, and unanimously carried, the following preambles and resolutions were adopted:

"Whereas, the common stock of this Corporation has been increased pursuant to a resolution duly adopted at a special meeting of the common stockholders held on the 19th day of December 1922, from Three Thousand (3,000) shares of the par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Three Hundred Thousand Dollars ($300,000) to Eighty Thousand
37 (80,000) shares of the par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Eight Million Dollars, ($8,000,000) and

"Whereas, the value of the assets of this Corporation exceeds the par value of the common stock now issued by more than Seven Million Dollars ($7,000,000), now, therefore, be it

"Resolved, that the proper officers of the Corporation are hereby authorized and directed to issue additional common stock to the amount of Seven Million Dollars ($7,000,000), and be it

"Further Resolved, that the said officers of the corporation be, and they are hereby authorized and directed to distribute said Seven Million Dollars ($7,000,000) of common stock, consisting of Seventy-Thousand (70,000) shares of the par value of One Hundred Dollars ($100), each, pro rata to common stockholders of the Corporation in the ratio of Seventy (70) shares to each three (3) shares held by common stockholders of record at the close of business on the 22nd day of December A. D. 1922."

* * * * * * *

Upon motion duly made, seconded, and carried, the foregoing minutes as read were approved as and for the minutes of this meeting.

Upon motion duly made, seconded, and carried, the meeting thereupon adjourned.

(Signed) E. B. Benson, *Secretary.*

38 *Schedule No. 4*

William R. Warner & Co., Inc.

Minutes of Special Meeting of the Board of Directors

A Special Meeting of the Board of Directors was held at the office of the Company, No. 113 West 18th Street, New York City, New York, on the 5th day of December 1923, at 11:35 o'clock in the forenoon.

There were present Messrs. Henry Pfeiffer, G. A. Pfeiffer, Edward Kallenbach, and Roger S. Baldwin, constituting a majority of the members of the Board of directors.

Mr. Henry Pfeiffer, the President, presided and called the meeting to order, and Mr. E. B. Benson, Secretary of the Company, acted as Secretary of the meeting.

Waiver of notice of the meeting, subscribed by all of the directors of the Company was presented by the Secretary and ordered to be placed on file.

On motion duly made, seconded, and unanimously carried, the following preambles and resolutions were adopted:

"Whereas, the total authorized common stock of this corporation amounts to eighty thousand (80,000) shares of the par value of One Hundred Dollars ($100) each, of which there still remains unissued seven thousand (7,000) shares, and

"Whereas, the surplus and profits of this corporation ex-
39 ceeds the par value of the common stock now issued by more than Seven Hundred Thousand Dollars ($700,000), now therefore, be it

"Resolved, that the proper officers of the corporation be and they hereby are authorized and directed to issue additional common stock to the amount of Seven Hundred Thousand Dollars ($700,000), and be it

"Further Resolved, that the said officers of the corporation be and they hereby are authorized and directed to distribute said Seven Hundred Thousand Dollars ($700,000) of common stock, consisting of seven thousand (7,000) shares of the par value of One Hundred Dollars ($100) each, pro rata to common stockholders of the corporation in the ratio of seven (7) shares to each seventy-three (73) shares held by common stockholders of record at the close of business on the 20th day of December, 1923."

* * * * * * *

Upon motion duly made, seconded and carried, the foregoing minutes as read were approved as and for the minutes of this meeting.

Upon motion duly made, seconded and carried, the meeting thereupon adjourned.

(Signed) ERNEST B. BENSON, *Secretary.*

40 *Schedule No. 5*

William R. Warner & Co., Inc.

Special Meeting of Board of Directors

A special meeting of the Board of Directors of William R. Warner & Co., Inc., was held at the office of Baldwin, Hutchins & Todd, No. 120 Broadway, Borough of Manhattan, New York City, on the 12th day of June, 1925, at 11:45 o'clock A. M.

There were present at said meeting Messrs. Henry Pfeiffer, Charles A. Pennock and Roger S. Baldwin, constituting a majority of the board. Those absent were Messrs. G. A. Pfeiffer and Edward Kallenbach.

The President of the Company, Mr. Henry Pfeiffer, presided, and called the meeting to order, and Mr. E. B. Benson, the secretary of the Company, acted as secretary of the meeting.

The secretary presented an agreement and written waiver of notice, signed by all of the directors, which was ordered to be placed on file.

On motion duly made, seconded and unanimously carried, the following preambles and resolutions were adopted:

"Whereas, the common stock of this corporation has been increased, pursuant to a resolution duly adopted at a special meeting of the common and preferred stockholders, held on the 16th day of April, 1925, from Eighty Thousand (80,000) shares of the par value of
41 One Hundred Dollars ($100) per share, amounting in the aggregate to Eight Million Dollars ($8,000,000) to One Hundred Thousand (100,000) shares of the par value of One Hundred ($100) per share, amounting in the aggregate to Ten Million Dollars ($10,000,000); and the preferred stock of this corporation has been increased, pursuant to a resolution duly adopted at the said special meeting of stockholders, from Twenty Thousand (20,000) shares of the par value of One Hundred Dollars ($100) a share, amounting in the aggregate to Two Million Dollars ($2,000,000) to Fifty Thousand (50,000) shares of the par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Five Million Dollars ($5,000,000), and

"Whereas the value of the assets of this corporation exceeds the par value of the common and preferred stock now issued by more than Three Million Dollars ($3,000,000); now, therefore, it is

"Resolved, that the proper officers of the corporation are hereby authorized and directed to issue additional common stock to the amount of Two Million Dollars ($2,000,000) par value and additional preferred stock to the amount of One Million Dollars ($1,000,000) par value, and be it

"Further Resolved, that the officers of the corporation be, and they hereby are, authorized and directed to distribute on July 7, 1925, said Two Million Dollars ($2,000,000) of common stock, consisting of
42 Twenty Thousand (20,000) shares of the par value of One Hundred Dollars ($100) each, pro rata to common stockholders of the corporation in the ratio of one (1) share of said common stock to each four (4) shares of common stock held by common stockholders of record at the close of business on July 6th. 1925, and to distribute said One Million Dollars ($1,000,000) of preferred stock, consisting of Ten Thousand (10,000) shares of the par value of One Hundred Dollars ($100) each, pro rata to common stockholders of the corporation in the ratio of one (1) share of said preferred stock to each eight (8) shares of common stock held by common stockholders of record at the close of business on July 6th, 1925."

On motion duly made, seconded, and unanimously carried, it was

"Resolved, that the U. S. Internal Revenue documentary stamps required to be affixed to the stubs of the certificates of new common

and preferred stock to be issued, such stamps amounting to the sum of Fifteen Hundred Dollars ($1,500), be paid for by the corporation."

* * * * * * *

Upon motion duly made, seconded, and carried, the foregoing minutes as read were adopted as and for the minutes of this meeting.

There being no further business to come before the meeting, it was, on motion duly made, seconded, and carried, adjourned.

(Signed) ERNEST B. BENSON, *Secretary.*

43 *Schedule No. 6*

William R. Warner & Co., Inc.

Minutes of Special Meeting of Board of Directors

A Special meeting of the Board of Directors was held at the office of the Company, No. 113 West 18th Street, Borough of Manhattan, New York City, on the 30th day of November 1926, at 9:50 o'clock in the forenoon.

There were present: Messrs. Henry Pfeiffer, Gustavus A. Pfeiffer, Edward Kallenbach, Charles A. Pennock, constituting a majority of the Board.

Mr. Henry Pfeiffer took the chair and called the meeting to order, and Mr. E. B. Benson acted as secretary of the meeting.

Waiver of notice of the meeting subscribed to by all of the directors of the Company, was presented by the Secretary, and was ordered to be placed on file.

* * * * * * *

Upon motion duly made, seconded, and unanimously carried, the following preambles and resolutions were adopted:

"Whereas, the Preferred Stock of this Corporation has been increased pursuant to a resolution duly adopted at a special meeting of the Common and Preferred Stockholders held on the 16th day of April 1925, from twenty thousand (20,000) shares of the par value of One Hundred Dollars ($100) a share, amounting in the aggregate to Two Million Dollars ($2,000,000.00) to fifty thousand shares of the par value of One Hundred Dollars ($100.00) a share amounting in the aggregate to Five Million Dollars ($5,000,000.00) of which increase ten thousand (10,000) shares aggregating in par value One Million Dollars ($1,000,000.00) were distributed on July 7, 1925, to Common Stockholders of record on July 6, 1925, as a stock dividend, leaving unissued twenty thousand (20,000) of the above shares of preferred stock, and

44

"Whereas, the value of the assets of this corporation exceeds the par value of the common and prefererd stock now issued by more than One Million Dollars ($1,000,000.00); now, therefore, be it

"Resolved, that the proper officers of this corporation be, and they hereby are, authorized and directed to issue additional preferred stock to the amount of One Million Dollars ($1,000,000.00) and be it

"Further Resolved, that the officers of this corporation be and they hereby are authorized and directed to distribute on December

31, 1926, said One Million Dollars ($1,000,000.00) of Preferred Stock consisting of Ten Thousand (10,000) shares at the par
45 value of One Hundred Dollars ($100.00) per share each, pro rata to common stockholders of this corporation in the ratio of one (1) share of said preferred stock to each ten (10) shares of common stock held by common stockholders of record at the close of business on December 30, 1926."

Upon motion duly made, seconded, and unanimously carried, it was

"Resolved, that the U. S. Internal Revenue documentary stamps required to be affixed to the stubs of the certificates of new preferred stock to be issued, such stamps amounting to the sum of Five Hundred Dollars ($500.00) be paid for by the corporation."

* * * * * * *

Upon motion duly made, seconded, and carried the foregoing minutes as read were approved as and for the minutes of this meeting.

Upon motion duly made, seconded, and carried, the meeting adjourned.

(Signed) Ernest B. Benson, *Secretary.*

Schedule No. 7

William R. Warner & Co., Inc.

Minutes of Special Meeting of Stockholders

A Special Meeting of the preferred and common stockholders of William R. Warner & Co., Inc., was held at the office of the
46 corporation, No. 113 West 18th Street, Borough of Manhattan, City, County, and State of New York, on the 27th day of November 1928, at ten o'clock A. M.

The meeting was called to order by Mr. Henry Pfeiffer, who, upon motion, was unanimously chosen Chairman, and Mr. E. B. Benson, Secretary of the corporation, was appointed Secretary of the meeting.

The Secretary then stated that a notice of the meeting, together with a proxy, had been mailed to each common and preferred stockholder of record on November 6, 1928, in accordance with the by-laws and Certificate of Incorporation of the corporation, and the Laws of the State of Delaware. A copy of the notice and of the proxy were ordered to be appended to the minutes of this meeting.

The Secretary then stated that according to the list of common and preferred stockholders as contained in the stock ledger, which was then opened and made available for inspection, there were present in person the following:

Name of stockholder	Number of shares	
	Common	Preferred
Henry Pfeiffer	24,235	79
E. B. Benson	None	[illegible]

The Secretary then stated that there were represented by proxy common stockholders owning 74,665 shares of common stock and preferred stockholders owning 29,404 shares of preferred stock, being more than a majority in interest of all of the common stock and more than a majority interest of all of the preferred stock of said William R. Warner & Co., Inc.

47 The proxies presented were ordered to be filed with the Secretary of the meeting.

The Secretary then read the minutes of the special meeting of the Board of Directors of the corporation held on the 5th day of November 1928, at 11:30 o'clock A. M., proposing an amendment to the Certificate of Incorporation of the corporation for the purpose of increasing the capital stock of the corporation from the sum of Fifteen Million Dollars ($15,000,000), consisting of Five Million Dollars ($5,000,000) of Preferred Stock and Ten Million Dollars ($10,000,000) of Common Stock, to the sum of Twenty-five Million Dollars ($25,000,000), to consist of Fifteen Million Dollars ($15,000,000) of Preferred Stock and Ten Million Dollars ($10,000,000) of Common Stock, and calling a special meeting of the Common and Preferred stockholders to vote upon such proposed amendment and increase of capital stock. At such special meeting of the Board of Directors, Messrs. E. B. Benson and Danforth Geer, Jr., were appointed judges to act at this special meeting of stockholders.

The Chairman thereupon directed that a vote of the Common and Preferred Stockholders by classes be taken by ballot upon the following resolution:

"Resolved, that the proposal of the Board of Directors that the Certificate of Incorporation of William R. Warner & Co., Inc., be amended by striking out all of the paragraph or article thereof numbered 'Fourth' as amended, to wit:

"'Fourth. The total authorized capital stock of the Corpora-

48 tion is fifty thousand (50,000) shares of Preferred Stock of the par value of One Hundred Dollars ($100) per share amounting in the aggregate to Five Million Dollars ($5,000,000) and one hundred thousand (100,000) shares of common stock of the par value of One Hundred Dollars ($100) per share amounting in the aggregate to Ten Million Dollars ($10,000,000).

"'The said fifty thousand (50,000) shares of Preferred Stock shall be entitled to receive, when and as declared, from the surplus or net profits of the Company, yearly dividends at the rate of six per centum (6%) per annum and no more, payable quarterly on the first weekday of October, January, April, and July beginning in January 1921. The dividends on the Preferred Stock shall be cumulative and shall be payable before any dividend on the Common Stock shall be paid or set apart, so that if in any year dividends amounting to six per cent (6%) shall not have been paid thereon, the deficiency shall be payable before any dividend shall be paid upon or set apart for the Common Stock. Whenever all cumulative dividends on the Preferred Stock for all previous years shall

have been declared and shall have become payable, and the accrued quarterly installments for the current year shall have been declared and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments or shall have set aside from its surplus or net profits a sum sufficient
49 for the payment thereof, the Board of Directors may declare dividends on the Common Stock payable then or thereafter, out of any remaining surplus or net profits. In the event of any liquidation or dissolution or winding up of the corporation (whether voluntary or involuntary) the holders of the Preferred Stock shall be entitled to be paid in full, both the par amount of their shares and the unpaid dividends accrued thereon, before any amount shall be paid to the holders of the Common Stock. Thereafter the remaining assets and funds shall be divided and paid to the holders of the Common Stock, according to their respective shares. The holders of the Preferred Stock shall not be entitled to vote. Such Preferred Stock shall be redeemable by the company or may be purchased by it on any quarterly dividend day in amounts of not less than one hundred (100) shares at the price of One Hundred and Five Dollars ($105) per share, together with all unpaid dividends accrued thereon.'"

and by inserting in lieu thereof, the following:

"Fourth. The total authorized capital stock of the Corporation is One Hundred and Fifty Thousand (150,000) shares of Preferred Stock of the par value of One Hundred Dollars ($100) per share amounting in the aggregate to Fifteen Million Dollars ($15,-
50 000,000) and one hundred thousand (100,000) shares of common stock of the par value of One Hundred Dollars ($100) per share amounting in the aggregate to Ten Million Dollars ($10,000,000).

"The said One Hundred and Fifty Thousand (150,000) shares of Preferred Stock shall be entitled to receive when and as declared, from the surplus or net profits of the Company, yearly dividends at the rate of six percentum (6%) per annum and no more, payable quarterly on the first weekday of January, April, July, and October. The dividends on the Preferred Stock shall be cumulative and shall be payable before any dividend on the Common Stock shall be paid or set apart, so that if in any year dividends amounting to six per cent (6%) shall not have been paid thereon, the deficiency shall be payable before any dividend shall be paid upon or set apart for the Common Stock. Whenever all cumulative dividends on the Preferred Stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly installments for the current year shall have been declared and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the Board of Directors may declare dividends on the Common Stock payable then
51 or thereafter, out of any remaining surplus or net profits. In

the event of any liquidation or dissolution or winding up of the corporation (whether voluntary or involuntary) the holders of the Preferred Stock shall be entitled to be paid in full, inclu the par amount of their shares and the unpaid dividends accrued thereon, before any amount shall be paid to the holders of the Common Stock. Thereafter the remaining assets and funds shall be divided and paid to the holders of the Common Stock, according to their respective shares. The holders of the Preferred Stock shall not be entitled to vote. Such Preferred Stock shall be redeemable by the company or may be purchased by it on any quarterly dividend day in amounts of not less than one hundred (100) shares at the price of One Hundred and Five Dollars ($105) per share, together with all unpaid dividends accrued thereon;"

be, and the same is hereby, authorized and approved, and that said Certificate of Incorporation be and it is hereby amended accordingly.

The stockholders thereupon proceeded to vote by classes by ballot, and after all ballots had been cast, the polls were declared closed.

The judges, after counting the ballots, reported that 99,000 shares of Common Stock were voted for such proposed amendment and that no shares of Common Stock were voted against the same, the said 99,000 shares of stock being more than a majority of the
52 Common Stock issued and outstanding, and that 29,593 shares of Preferred Stock were voted for such proposed amendment and no shares of Preferred Stock were voted against the same, the said 29,593 shares of Preferred Stock being more than a majority of all of the Preferred Stock issued and outstanding.

The Chairman thereupon declared the proposed amendment to the Certificate of Incorporation adopted.

The foregoing minutes as read were approved as and for the minutes of this meeting.

There being no further business to come before the meeting, it was, upon motion made, seconded, and carried, adjourned.

(Signed) Ernest B. Benson, *Secretary.*

Schedule No. 8

William R. Warner & Co., Inc.

Special Meeting of Board of Directors

A special meeting of the Board of Directors of William R. Warner & Co., Inc., was held at the office of the Company, No. 113 West 18th Street, Borough of Manhattan, City, County, and State of New York, on the 18th day of December 1928, at 10:00 o'clock A. M.

There were present at said meeting: Messrs. Henry Pfeiffer, Gustavus A. Pfeiffer, Edward Kallenbach, constituting a majority of the Board, those absent being Messrs. Charles A. Pennock and Roger S. Baldwin.

53 The President of the Corporation, Mr. Henry Pfeiffer, presided and called the meeting to order, and Mr. E. B. Benson,

the Secretary of the corporation, acted as Secretary of the meeting.

The Secretary presented a written waiver of notice, signed by all of the Directors, which was ordered to be placed on file.

On motion duly made, seconded, and unanimously carried, the following preambles and resolutions were adopted:

"Whereas, the Preferred Stock of this Corporation has been increased, pursuant to a resolution duly adopted at a special meeting of the Common and Preferred Stockholders, held on the 27th day of November 1928, from Fifty Thousand (50,000) shares of the par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Five Million Dollars ($5,000,000), to One hundred fifty thousand (150,000) shares of the par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Fifteen Million Dollars ($15,000,000), and

"Whereas, the value of the assets of this corporation exceeds the par value of the Common and Preferred Stock now issued by more than Five Million Dollars ($5,000,000); Now, Therefore, it is

"Resolved, that the proper officers of this corporation are hereby authorized and directed to issue additional Preferred Stock
54 to the amount of Five Million Dollars ($5,000,000) par value, and be it

"Further Resolved, that the officers of this corporation be, and they hereby are, authorized and directed to distribute on December 31, 1928, said Five Million Dollars ($5,000,000) of Preferred Stock, consisting of Fifty Thousand (50,000) shares of the par value of One Hundred Dollars ($100) each, pro rata to Common Stockholders of this corporation in the ratio of One (1) share of said Preferred Stock to each Two (2) shares of Common Stock held by Common Stockholders of record at the close of business on December 1, 1928."

On motion duly made, seconded, and unanimously carried, it was

"Resolved, that the United States Internal Revenue documentary stamps required to be affixed to the stubs of the certificates of new Preferred Stock to be issued, such stamps amounting to the sum of Twenty-five Hundred Dollars (2,500), be paid for by this corporation."

. . . . . .

Upon motion duly made, seconded, and carried, the foregoing minutes, as read, were approved as and for the minutes of this meeting.

Upon motion duly made, seconded, and carried, the Meeting thereupon adjourned.

(Signed) ERNEST B. BENSON, *Secretary.*

55 *Schedule No. 9*

William R. Warner Corporation

Special Meeting of Board of Directors

A special meeting of the Board of Directors of William R. Warner Corporation was held at the office of the Company, 113 West 18th

Street, New York City, on the 24th day of April 1931, at 11:00 o'clock in the forenoon.

The following persons were present: Messrs. Henry Pfeiffer, Gustavus A. Pfeiffer, Edward Kallenbach, constituting a quorum of the Board.

Mr. Henry Pfeiffer, President of the Corporation, acted as President of the meeting, and Mr. Ernest B. Benson, Secretary of the Corporation, acted as Secretary of the meeting.

Waiver of Notice of the meeting subscribed to by all of the Directors of the Corporation was presented by the Secretary, and was ordered placed on file.

On motion duly made, seconded, and unanimously carried, the following preambles and resolutions were adopted:

"Whereas the Preferred Stock of this Corporation has been increased pursuant to a resolution duly adopted at a Special Meeting of the Common and Preferred Stockholders, held on the 27th day of November 1928, from fifty thousand (50,000) shares of the
56 par value of one hundred dollars ($100) per share, amounting in the aggregate to five million dollars ($5,000,000) to one hundred fifty thousand (150,000) shares of the par value of one hundred dollars ($100) per share, amounting in the aggregate to fifteen million dollars ($15,000,000), of which increase fifty thousand (50,000) shares, aggregating in par value five million dollars ($5,000,000) were distributed on December 31st, 1928, to Common Stockholders of record on December 1st, 1928, as a stock dividend, leaving unissued fifty thousand (50,000) of the above shares of Preferred Stock, and

"Whereas the value of the assets of this corporation exceeds the par value of the Common and Preferred Stock now issued by more than ~~two million~~ five hundred thousand dollars ($2,500,000).

"Now, therefore, it is Resolved, that the proper Officers of this Corporation are hereby authorized and directed to issue additional Preferred Stock to the amount of two million five hundred thousand dollars ($2,500,000) par value.

"And be it Further Resolved, that the Officers of this Corporation, be and they hereby are authorized and directed to distribute on April 27th, 1931, said two million five hundred thousand dollars ($2,500,000) of Preferred Stock, consisting of twenty-five thousand (25,000) shares of the par value of one hundred dollars ($100) each,
57 pro rata to Common Stockholders of this Corporation in the ratio of one (1) share of said Preferred Stock to each four (4) shares of Common Stock held by Common Stockholders of record at the close of business on April 2nd, 1931."

On motion duly made, seconded, and unanimously carried, it was

"Resolved, that the United States Internal Revenue Documentary Stamps required to be affixed to the stubs of the certificates of new Preferred Stock to be issued, such stamps amounting to the sum of one thousand two hundred fifty dollars ($1,250), be paid for by this Corporation.

Upon motion duly made, seconded, and carried the foregoing minutes as read were approved as and for the minutes of this meeting.

Upon motion duly made, seconded, and carried, the meeting adjourned.

(Signed) ERNEST B. BENSON, *Secretary.*

58 *Schedule No. 10*

William R. Warner Corporation and subsidiary and affiliated companies

Consolidated balance sheet as at January 1, 1921, 1929, 1931 & December 31, 1931

ASSETS

	Jan. 1, 1921	Jan. 1, 1929	Jan. 1, 1931	Dec. 31, 1931
Current and Working Assets:				
Cash on Hand and in Banks	$254,232.49	$1,264,905.78	$1,178,854.18	$1,074,359.02
Investment in Marketable Securities		9,063,154.22	5,216,487.88	4,863,731.89
Trade Accounts & Notes Receivable (Less Reserves)	1,822,007.89	4,541,769.21	3,955,379.24	3,158,833.01
Miscellaneous Accounts and Notes Receivable and Accruals	45,332.15	169,494.46	158,089.89	219,718.80
Inventories	3,041,845.23	3,929,125.96	4,373,973.63	3,417,770.42
Total Current and Working Assets	5,163,417.76	18,968,449.63	14,882,784.82	12,734,413.14
Miscellaneous Investments and Advances		927,809.79	861,276.13	584,472.76
Fixed Assets (Less Reserves)	2,684,117.59	3,495,323.22	4,799,588.93	4,870,362.56
Trademarks, Tradenames and Formulae	2,558,142.51	3,833,814.36	10,718,803.58	11,284,427.21
Deferred Charges	158,259.64	588,359.65	873,357.73	875,674.77
	10,563,937.50	27,813,756.65	32,135,811.19	30,349,370.44

LIABILITIES

	Jan. 1, 1921	Jan. 1, 1929	Jan. 1, 1931	Dec. 31, 1931
Current Liabilities:				
Notes Payable	$769,250.00		$1,089,000.00	
Accounts Payable—Trade	488,698.33	$678,541.41	624,165.89	$394,485.37
Miscellaneous Accounts Payable and Accruals	230,368.14	595,048.86	458,157.73	459,455.32
Dividends Payable	23,822.41	261,241.72	296,970.83	282,725.02
Income Tax	347,640.50	486,039.12	305,214.94	302,713.31
Total Current Liabilities	1,859,779.38	2,020,871.11	2,773,509.39	1,439,379.02
Mortgage	787,500.00		23,808.75	
Capital Stock:				
Preferred:				
Authorized	2,000,000.00	15,000,000.00	15,000,000.00	15,000,000.00
Less Unissued and in Treasury	1,073,700.00	6,569,600.00	6,895,500.00	5,627,800.00
Outstanding	926,300.00	8,430,400.00	8,104,500.00	9,372,200.00
Common:				
Authorized	300,000.00	10,000,000.00	10,000,000.00	10,000,000.00
Less in Treasury				50,000.00
Outstanding	300,000.00	10,000,000.00	10,000,000.00	9,950,000.00
Outstanding Preferred & Common	1,226,300.00	18,430,400.00	18,104,500.00	19,322,200.00
Stock of Subsidiary Companies in Hands of Public and Employees:				
Preferred	698,200.00	605,100.00	661,100.00	615,838.50
Common (at book value)		503.37	700.90	833.88
	698,200.00	605,603.37	661,800.90	616,672.38
Surplus:				
Appropriated (Statutory and Special reserves)		25,721.79	149,697.62	125,512.46
Profit and Loss (Earned Surplus)	5,992,158.12	6,731,160.38	10,422,494.53	8,845,606.58
	5,992,158.12	6,756,882.17	10,572,192.15	8,971,119.04
	10,563,987.50	27,813,756.65	32,135,811.19	30,349,370.44

59 *Schedule 10* (Continued).

William R. Warner Corporation and Subsidiary and Affiliated Companies

Reconciliation of Surplus Account for the Year Ending December 31, 1931

Balance at January 1, 1931			$10,422,494.53
Additions:			
Adjustment of income tax reserve of previous year		$4,228.85	
Transfers—Statutory and special reserves		23,730.00	
Sundry additions—Net		579.83	
Net profit for year after providing for income tax		2,668,663.76	
			2,697,202.44
			13,119,696.97
Deductions:			
Cash dividends paid—			
On common stock	$797,333.33		
On preferred stock	624,071.58		
		1,421,404.91	
Stock dividends paid in preferred stock		2,500,000.00	
Premium paid on purchase of common stock		100,000.00	
Special depreciation of fixed assets		40,602.74	
Income taxes, prior years		4,951.34	
Minority stockholders' portion of profits		132.98	
Adjustment re: Chamberlain Medicine Co		37,188.35	
Difference in exchange on opening balance		169,810.07	
			4,274,090.39
Balance at Dec. 31, 1931			8,845,606.58

60 *Schedule No. 11*

William R. Warner Corporation

Comparative balance sheet as at January 1, 1921, 1929, 1931, & December 31, 1931

ASSETS

	Jan. 1, 1921	Jan. 1, 1929	Jan. 1, 1931	Dec. 31, 1931
urrent:				
Cash on Hand and in Banks	150,437.43	471,953.97	136,961.95	150,226.36
Investments in Marketable Securities		8,619,160.47	4,685,547.88	4,788,775.23
Trade Accounts & Notes Receivable (Less Reserves)	1,275,019.01	1,856,222.31		
Miscellaneous Accounts and Notes Receivable and Accruals	30,163.23	119,846.55	31,962.93	35,182.26
Inventories	410,128.15	688,803.41		
Total Current Assets	1,865,807.82	11,755,936.71	4,854,472.76	4,974,183.85
Investments in Subsidiary Companies	3,073,906.87	5,552,417.41	12,642,222.14	12,731,424.66
Intercompany Accounts Receivable	650,267.67	4,443,454.09	4,120,536.78	7,846,306.05
Miscellaneous Investments & Advances		555,636.13	247,375.00	317,367.66
Fixed Assets (less Reserves)	389,688.42	212,382.18		
Trademarks, Tradenames, & Formulae		286,270.33		
Deferred Charges	50,494.72	165,133.79		
	6,030,165.50	22,965,280.64	21,864,606.68	25,869,482.22

61 *Schedule 11* (Continued)

Comparative balance sheet as at January 1, 1921, 1929, 1931, & December 31, 1931 —Continued

LIABILITIES

	Jan. 1, 1921	Jan. 1, 1929	Jan. 1, 1931	Dec. 31, 1931
Current:				
Notes Payable	554, 230. 00			
Accounts Payable—Trade	292, 391. 04	206, 814. 80		
Miscellaneous Accounts Payable and Accruals	140, 232. 52	177, 341. 33		
Dividends Payable	11, 497. 16	251, 395. 80	260, 232. 66	279, 057. 89
Income Tax	32, 817. 26	97, 645. 88		
Total Current Liabilities	1, 031, 187. 98	733, 197. 81	260, 232. 66	279, 057. 89
Intercompany Accounts Payable	2, 562, 908. 93			
Capital Stock:				
Preferred (less unissued and in Treasury)	926, 300. 00	8, 430, 400. 00	8, 104, 500. 00	9, 372, 200. 00
Common (less Treasury)	300, 000. 00	10, 000, 000. 00	10, 000, 000. 00	9, 950, 000. 00
Surplus:				
Reserve for Net Assets	188, 099. 93	188, 099. 93	907, 829. 60	907, 829. 60
Profit and Loss	1, 021, 668. 66	3, 613, 582. 90	2, 592, 044. 42	5, 360, 394. 73
	6, 030, 165. 50	22, 965, 280. 64	21, 864, 606. 68	25, 869, 482. 22

William R. Warner Corporation

Reconciliation of surplus for the year ended December 31, 1931

Balance at December 31, 1930			$2, 592, 044. 42
Additions:			
Dividends from Subsidiary Companies:			
Domestic		6, 870, 810. 00	
Foreign		7, 485. 59	
			6, 878, 295. 59
			9, 470, 340. 01
Deductions:			
Net Loss for the Year		127, 153. 99	
Cash Dividends Paid—			
On Common Stock	797, 333. 33		
On Preferred Stock	585, 457. 96		
		1, 382, 791. 29	
Stock Dividends paid in Preferred Stock		2, 500, 000. 00	
Premium paid on purchase of Common Stock		100, 000. 00	
			4, 109, 945. 28
Balance at December 31, 1931			$5, 360, 394. 73

62 *Schedule No. 12*

William R. Warner & Co., Inc.

Year	Consolidated taxable income (Intercompany items eliminated)	Earnings of parent company (Including dividends received from subsidiaries)	Cash dividends	
			Preferred	Common
1920 (1 mo.)	$128, 211. 89	$18, 270. 37	$9, 000. 00	$13, 500. 00
1921	1, 324, 699. 31	89, 211. 08	62, 447. 84	73, 500. 00
1922	1, 881, 293. 11	6, 674, 171. 76	120, 764. 85	333, 000. 00
1923	2, 937, 270. 19	2, 228, 878. 80	116, 406. 34	299, 000. 00
1924	3, 342, 012. 68	750, 692. 20	156, 955. 41	400, 000. 00
1925	3, 904, 720. 16	4, 082, 471. 20	150, 311. 35	540, 000. 00
1926	4, 158, 726. 46	2, 314, 269. 18	232, 993. 14	600, 000. 00
1927	4, 029, 340. 74	3, 061, 092. 38	235, 332. 67	800, 000. 00
1928	3, 679, 918. 31	8, 493, 617. 11	242, 373. 93	800, 000. 00
1929	3, 393, 283. 94	1, 580, 336. 02	544, 449. 28	800, 000. 00
1930	2, 148, 901. 85	1, 562, 182. 08	535, 814. 92	737, 569. 48
1931	2, 380, 079. 34	7, 819, 939. 61	622, 386. 32	797, 333. 33
Total	$33, 308, 457. 98	$38, 675, 131. 79	$3, 032, 236. 05	$6, 193, 902. 81

NOTE 1.—The earnings of the Pennsylvania corporation for the years 1908 to December 1920 are not considered material to the issues now under consideration and are not shown on this schedule.

NOTE 2.—The "cash dividends" column does not include the redemption of the 8,500 shares of preferred stock in December 1931.

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $3,000
AND INCOMES FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1931

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1932

FIRST NAME AND ADDRESS PLAINLY BELOW

MRS. ANNIE M. PFEIFFER
370 Riverside Drive,
New York (City) New York (County) New York (State)
Occupation None

No. 2281
Serial Number 391382
Collector's District S. New York

1. Are you a citizen or resident of the United States? Yes
2. If you filed a return for 1930, to what Collector's office was it sent? 3rd N.Y.
3. Is this a joint return of husband and wife? No
4. State name of husband or wife if a separate return was made and the Collector's office to which it was sent. Henry Pfeiffer 3rd N.Y. dist
5. Were you married and living with husband or wife on the last day of your taxable year? Yes
6. If not, were you on the last day of your taxable year separated by decree of divorce or separate maintenance, or living apart? —
7. If your status as respect to questions 5 and 6 changed during the year, state date and nature of change. —
8. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support were receiving their chief support from you on the last day of your taxable year? None

INCOME

1. Salaries, Wages, Commissions, etc. (State name and address of employer)	125,660.67			
2. Income from Business or Profession. (State business)				
3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (Except interest on tax-free covenant bonds)		10	439	65
4. Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source				
5. Income from Partnerships. (State name and address) 11-29-33 Widow A-5 12-12-35				
6. Income from Fiduciaries. (State name and address)				
7. Rents and Royalties. (From what property?)				
8. Profit from Sale of Real Estate, Stocks, Bonds, etc. (From what?)				
9. Taxable Interest on Liberty Bonds, etc. (From what?)		2	762	50
10. Dividends on Stock of Domestic Corporations		207	165	60
11. Other Income (including dividends on stock of foreign corporations). (State nature of item) DEPT MAR 14 '32				
(a)				
(b)				
12. TOTAL INCOME (Items 1 to 11)				810 367 75

DEDUCTIONS

13. Interest Paid			62	96
14. Taxes Paid. (Explain in Schedule F)		7	217	16
15. Losses by Fire, Storm, etc. (Explain in Schedule F and if part of loss is recovered, state amount and how)				
16. Bad Debts. (Explain in Schedule F)				
17. Depreciation. (Explain in Schedule F)		69	885	02
18. Other Deductions Authorized by Law. (Explain in Schedule F)		17	287	50
19. TOTAL DEDUCTIONS (Items 13 to 18)				94 458 64
20. Net Income (Item 12 minus Item 19)				215 916 11

EARNED INCOME CREDIT

21. Earned Income (not over $20,000)	$5000	00
22. Less Personal Exemption and Credit for Dependents	None	
23. Balance (Item 21 minus 22)	$5000	00
24. Amount taxable at 1½% (not over $4,000)	$4000	00
25. Amount taxable at 3% (not over $8,000)	1000	00
26. Amount taxable at 6% (Balance over $8,000 of Item 23)		
27. Normal Tax (1½% of Item 24)	$ 60	00
28. Normal Tax (3% of Item 25)	30	00
29. Normal Tax (6% of Item 26)		
30. Surtax on Item 21		
31. Tax on Earned Net Income (total of Items 27 to 30)	$ 90	00
32. Credit of 25% of Tax (not over 25% of Items 24, 25, 26, and 29)	$ None	

COMPUTATION OF TAX (See Instruction 29)

33. Net Income (Item 20 above)			$215925	11
34. Liberty Bond Interest (Item 9)	$ 2762	50		
35. Dividends (Item 10)	207165	60		
36. Credit for Dependents				
37. Personal Exemption				
38. Total of Items 34 to 37			209928	10
39. Balance (Item 33 minus 38)			$ None	
40. Amount taxable at 1½% (not over $4,000)				
41. Balance (Item 39 minus 40)				
42. Amount taxable at 3% (not over $4,000)				
43. Amount taxable at 6% (Item 41 minus 42)				
44. Normal Tax (1½% of Item 40)			$	
45. Normal Tax (3% of Item 42)				
46. Normal Tax (6% of Item 43)				
47. Surtax on Item 20 (complete instruction 32)			34843	08
48. Tax on Net Income (total of Items 44 to 47)			$	
49. Tax on Capital Gain or Loss (12½% of Col. 6, Sched. D)				
50. Total of or difference between Items 48 and 49			67855	58
51. Less Credit of 25% of Tax on Earned Income (Item 32)				
52. Total Tax (Item 50 minus 51)			$	
53. Less Income Tax Paid at Source				
54. Income Tax paid to a foreign country or U. S. possession				
55. Balance of Tax (Item 52 minus Items 53 and 54)			67855	58

AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements, has been examined by me, and to the best of my knowledge and belief, is a true and complete return made in good faith for the taxable year stated, pursuant to the Revenue Act of 1928 and the Regulations issued thereunder.

Sworn to and subscribed before me this 14th day of MARCH, 1932.

Annie M. Pfeiffer
(Signature of taxpayer)

(Address of agent)

An extended return cannot be granted unless 90% of the tax estimated and shown on the return is paid on or before the date fixed for filing the return. Remittances and drafts will be accepted only if payable at par.

7-

SCHEDULE A—INCOME FROM BUSINESS OR PROFESSION (See Instruction 3)

1. Total receipts from business or profession (State kind of business)

Cost or Gross Sale

2. Labor
3. Material and supplies
4. Merchandise bought for sale
5. Other costs (Itemize below or on separate sheet)
6. Plus inventory at beginning of year
7. Total (Lines 2 to 6)
8. Less inventory at end of year
9. Net Cost or Gross Sale (Line 7 minus Line 8)

Enter "C," or "C or M," on Lines 6 and 8 to indicate whether inventories are valued at cost, or cost or market, whichever is lower

Gross Business Deductions

10. Salaries not included on "Labor," in Line 2. (Do not deduct compensation for your services)
11. Interest on business indebtedness to others
12. Taxes on business and business property
13. Losses (explain in table at foot of page)
14. Bad debts arising from sales or services
15. Depreciation, obsolescence, and depletion (explain in table provided at foot of page)
16. Rents, royalties, and other expenses (Itemize below or on separate sheet)
17. Total (Lines 10 to 16)
18. Total Deductions (Line 9 plus Line 17)
19. Net Profit (Line 1 minus Line 18) (Enter on Page 2)

Explanation of deductions claimed on Lines 5 and 16

SCHEDULE B—INCOME FROM RENTS AND ROYALTIES (See Instruction 7)

1. Kind and Location of Property	2. Amount Received	3. Cost or Value as of March 1, 1913, if Acquired Thereafter	4. Depreciation (Section to be allowed at foot of page)	5. Interest	6. Taxes, Repairs, and Other Expenses (Itemize below)	7. Net Profit (Enter on Page 2)

Explanation of deductions claimed in Column 6

SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 8)

1. Kind and Location of Property	2. Date Acquired	3. Amount Realized	4. Cost or Value as of March 1, 1913, if Acquired Thereafter	5. Depreciation (Section to be allowed at foot of page)	6. Expenses of Sale	7. Net Profit (Enter on Page 2)

State how property was acquired

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN TWO YEARS (See Instruction 9a)

1. Kind and Location of Property	2. Date Acquired (Mo. Day Yr.)	3. Date Sold (Mo. Day Yr.)	4. Amount Received	5. Depreciation Allowed (See Instruction 9b)	6. Cost or Value as of March 1, 1913, if Acquired Thereafter	7. Depreciation (See Instruction 9b)	8. Expenses of Sale	9. Net Gain or Loss (Enter in Item 10)
2000 shs. William R. Warner Corp. preferred	12/31/28	12/29/31	200,000 00		19,900 00			180,100 00

State how property was acquired William R.Warner Corp.Preferred stock received as Stock Dividend.See note below

SCHEDULE E—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OR SECURITIES (See Instruction 9)

1. Obligations on Securities	2. Interest Received or Accrued	3. Amount Owned	4. Purchase Amount, Par or Face Value	5. Amount Owned at Expense of Estate	6. Interest on Amount in Column 5 (Enter in Item 9)
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia	16310 44		All		
(b) Securities issued under Federal Farm Loan Act, or under such Act as amended, Treasury Bills, and Treasury Certificates of Indebtedness	5625 00		All		
(c) Liberty 3½% Bonds and other obligations of United States issued on or before September 1, 1917, and obligations of U. S. possessions			All		
(d) Liberty 4% and 4½% Bonds, Treasury Bonds, and Treasury Savings Certificates	2975 00	7000 00	$4,000	65000 00	2762 50
(e) Treasury Notes			None		

SCHEDULE F—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 1, 14, 16, 17, AND 18

Item 14- New York State Income Tax - $7,217.16

Item 18- Loss from Sale of Stocks - Schedule attached

Note in reference to Schedule D: The determination of the basis of the Wm. R. Warner Corporation stock dividend is complicated. The method and valuations used in making computation are on record in the office of Baldwin, Hutchins & Todd, 120 Broadway, New York City. It is requested that the agent make his examination of the correctness of the basis used in that office.

EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES A AND B

1. Kind of Property (If buildings, state material of which constructed)	2. Date Acquired	3. Cost or Other Basis	4. Previous Depreciation Allowances	5. Cost or Value as of March 1, 1913, if Acquired Thereafter (Deduction at Rate of ... Per Cent)	Amount of Depreciation Claimed on 6. Previous years	Amount of Depreciation Claimed on 7. This year

EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC., CLAIMED IN SCHEDULE A, AND IN ITEM 18

1. Kind of Property	2. Date Acquired	3. Cost or Value as of March 1, 1913, if Acquired Thereafter	4. Depreciation Allowances	5. Amount of Insurance Collected	6. Deduction Net Loss Claimed

P/L 11-2

65 **Mrs. Annie M. Pfeiffer, 1931**

Schedule F, Item 17—Contributions

Allen Memorial Hospital, Waterloo, Iowa	$12,500.00
American Red Cross, New York, N. Y	250.00
Anti-Saloon League of America, Westerville, Ohio	100.00
Baxter Seminary, Baxter, Tenn	5,000.00
Bethany Evangelical Church, Highland Park, Illinois	15,499.99
Biblical Seminary, New York, N. Y	750.00
Big Brother & Big Sister Federation, Inc., New York, N. Y	25.00
Board of Education of M. E. Church, Chicago, Ill	2,500.00
Board of Foreign Missions of M. E. Church, New York, N. Y	27,750.00
Bryan Memorial University, Dayton, Tenn	100.00
Committee on Cooperation in Latin America, New York, N. Y	300.00
Committee on Wayside Evangelism, New York, N. Y	125.00
Cornell College, Mt. Vernon, Iowa	25,000.00
Cornell M. E. Church, New York, N. Y	75.00
Dakota Wesleyan University, Mitchell, S. D	5,000.00
Evangelical Church, Dubuque, Iowa	1,000.00
Everett Babtist Church, Everett, Wash	150.00
Evangelical Church, Laurel, Mont	25.00
Evangelical Church, Waterloo, Iowa	50.00
Evangelical Theological Seminary, Naperville, Ill	5,000.00
Five Points Mission, New York, N. Y	2,550.00
Greater New York Federation of Churches, New York	1,200.00
Hadley Rescue Hall, New York, N. Y	25.00
Henry Street Settlement Visiting Nurse Service, New York, N. Y	35.00
Iowa Wesleyan College, Mt. Pleasant, Iowa	12,500.00
Jefferson Park M. E. Church, New York, N. Y	150.00
Kansas Wesleyan University, Salina, Kansas	1,000.00
Korean M. E. Church, New York, N. Y	19.00
Methodist Episcopal Church Home, New York, N. Y	262.50
Methodist Episcopal Church, Gloucester, N. J	50.00
National Hymn Sing, New York, N. Y	25.00
Near East College Assn., New York, N. Y	500.00
New York Assn. for the Blind, New York, N. Y	25.00
Near East Foundation, New York, N. Y	50.00
New York Bible Society, New York, N. Y	25.00
New York City Society of M. E. Church, New York	2,550.00
New York Deaconess Assn., M. E. Church, New York	1,309.69
Piney Wood School, Piney Wood, Miss	225.00
Seamen's Church Institute of N. Y., New York, N. Y	10.00
St. Paul's M. E. Church, New York, N. Y	3,758.00
Volunteers of America, New York, N. Y	50.00
Wilmington College, Wilmington, Ohio	5,000.00
Women's Christian College, Japan	275.00
Women's Foreign Missionary Society of M. E. Church College Buildings, Seoul, Korea	25,000.00
Y. M. C. A., New York, N. Y	150.00
Y. W. C. A., New York, N. Y	200.00
	$158,144.18

66 The amount deductible is limited to 15% of the sum of net income (computed without deducting any contributions) and capital net gain.

The computation is as follows:

Gross income	$310,367.75
Less deductions	24,567.62
	$285,800.13
Add Capital Gain	180,000.00
	$465,960.13
15%	69,885.02

Mrs. Annie M. Pfeiffer, 1931

Schedule F, Item 18.—Loss from Sale of Stocks

Name of security	Date acquired	Amount realized	Cost	Loss
Illinois Central Ry. Co.	11/8/30	$1,037.50	$9,300.00	$8,262.50
United States Steel Corporation	8/24/31	3,837.50	8,600.00	4,762.50
United States Steel Corporation	9/10/31	3,837.50	8,100.00	4,262.50
		$8,712.50	$26,000.00	$17,287.50

67 Before United States Board of Tax Appeals

Docket No. 82,616

ANNIE M. PFEIFFER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

M. Ward Whalen, Esq., and Warren W. Grimes, Esq., for the Petitioner.

Hartford Allen, Esq., and Walter W. Kerr, Esq., for the Respondent.

Memorandum opinion

MURDOCK: The Commissioner determined a deficiency of $125,660.67 in the petitioner's income tax for 1931. The errors assigned by the petitioner are (a) the action of the Commissioner in including in income $629,125, the fair market value of 6,291¼ shares of preferred stock of William R. Warner Corporation received by the petitioner as a dividend upon common stock of the corporation (b) the action of the Commissioner in including in income as a dividend $200,000 received from the redemption of 2,000 shares of preferred stock of the same corporation. The facts have been stipulated and need not be set forth in full here.

The corporation was organized in 1920. Its stock at all times consisted of common and preferred. Each had a par value of $100 per share but they were otherwise essentially different.
68 The authorized capital was increased at several times by capitalizing earnings. There was an increase in 1928 at which time the preferred was increased from $5,000,000 to $15,000,000 and the common was allowed to remain at $10,000,000. The corporation distributed $5,000,000 par value of preferred pro rata to common stockholders on December 31, 1928, and $2,500,000 par value of preferred pro rata to common stockholders on April 27, 1931. Each of these shares had a fair market value of $100 at the date distributed.

The following table shows how the stock was held at the times the distributions were authorized:

Stockholder	Common	Preferred	
		1928	1931
Annie M. Pfeiffer	25,165	2,122	9,642
Gustavus Pfeiffer	49,500	5,895	24,034
Henry Pfeiffer	24,335	79	6,901
C. Leonard Pfeiffer	1,000	270	150
Employees and others		25,938	38,813
	100,000	34,304	79,540

The petitioner received 12,582 shares in the 1928 distribution and 6,291¼ shares in the 1931 distribution. Dividends upon the preferred stock were never in default. There was no accumulation of unpaid dividends on the preferred on April 27, 1931.

The corporation on December 29, 1931, redeemed with cash at par 8,500 shares of preferred including 2,000 shares belonging to the petitioner which she had received in the 1928 distribution.
69 The balance of the shares redeemed belonged 4,500 to Gustavus Pfeiffer and 2,000 to Henry Pfeiffer.

The petitioner reported in her 1931 return a capital gain of $180,-100 as resulting from the redemption of the 2,000 shares after deducting a basis computed for stock received as a stock dividend.

The Commissioner in determining the deficiency eliminated the capital gain and included as dividends $200,000 representing the redemption and $629,125 representing the dividend in preferred stock.

The petitioner contends that the dividend in preferred stock was a stock dividend within the meaning of section 115 (f) of the Revenue Act of 1928, and not subject to tax in 1931. The Board has held otherwise. James H. Torrens, 31 B. T. A. 787; H. C. Gowran, 32 B. T. A. 820. Cf. Tillotson Manufacturing Company, 27 B. T. A. 913; affirmed, 76 Fed. (2d) 189; Koshland v. Helvering, — U. S. — (May 18, 1936).

The Commissioner held that the redemption of the 2,000 shares in 1931 was at such time and in such manner as to be substantially equivalent to a taxable dividend in 1931, within the meaning of section 115 (g) of the Revenue Act of 1928. He erred in this since the distribution was subject to tax as a dividend in 1928 (see cases above cited). Thereafter the shares had a basis for gain or loss to the petitioner of $100 each, and they were redeemed without gain or loss to the petitioner at $100 each in 1931.

Decision will be entered under Rule 50.

Enter:

Entered, June 27, 1936.

70 Before United States Board of Tax Appeals

Docket No. 82616

ANNIE M. PFEIFFER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Pursuant to the Board's Memorandum Opinion entered June 27, 1936, the respondent filed a proposed recomputation and notice of settlement on July 13, 1936. On July 18, 1936, the petitioner filed a notice of acquiescence to the recomputation filed by the respondent. Therefore, it is

Ordered and decided, that there is a deficiency for the year 1931 in the amount of $89,841.75.

Entered, July 22, 1936.

[SEAL] (S.) J. E. MURDOCK,
Member, United States Board of Tax Appeals.

71 In United States Circuit Court of Appeals

[Title omitted.]

Petition for review.

Filed Aug. 7, 1936

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

Now comes the Petitioner, by her attorney, Roger S. Baldwin, and respectfully shows:

Jurisdiction for Review

I. This is a proceeding for a review by the United States Circuit Court of Appeals of the Second Circuit of a Decision of the United States Board of Tax Appeals entered July 22, 1936, Docket No. 82616, partially affirming the deficiency heretofore determined by the Commissioner of Internal Revenue in income tax of the Petitioner for the year 1931 and fixing such deficiency in the amount of $89,841.75.

72 II. The Petitioner on review (hereinafter referred to as "Taxpayer") is an individual, a citizen and resident of the City, County, and State of New York, and her Federal Income Tax Return for the year 1931 was filed with the Collector of Internal Revenue for the Third District of New York, in the

Borough of Manhattan, City, County, and State of New York, in the Judicial Circuit of the United States Circuit Court of Appeals for the Second Circuit, which return was the return of the tax in respect of which the alleged deficiency or liability arises.

The Respondent on review (hereinafter referred to as "Commissioner") is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

Nature of Controversy

III. The nature of the controversy is as follows:

"1. Whether a dividend paid on the common stock of a corporation in its own preferred stock is exempt from taxation under the Revenue Act of 1928 and other applicable Statutes of the United States.

"2. Whether such a preferred stock dividend is made taxable by reason of the fact that at the time such preferred stock dividend was paid there was outstanding other preferred stock of the same class.

"3. Whether a dividend paid on the common stock of a corporation in its own preferred stock, at a time when there was other
73 preferred stock of the same class outstanding, is exempt from taxation under the Constitution of the United States.

"4. If such stock dividend is not exempt from taxation under the applicable Statutes of the United States or under the Constitution of the United States, whether such stock dividend was distributed under such circumstances as to render it exempt from taxation as having been distributed in pursuance of a Plan of Reorganization of the Corporation within the meaning of the provisions of Section 112 of the Revenue Act of 1928."

Summary of Facts

The Taxpayer was on and prior to April 27, 1931, the owner of 25,165 shares of common stock of William R. Warner Corporation, a Delaware corporation (hereinafter sometimes referred to as "Corporation").

On April 27, 1931, the Taxpayer received 6,291¼ shares of preferred stock of the Corporation with a par value of $100 per share as a dividend on the common stock of the Corporation so held by her, such dividend being her pro rata share of 25,000 shares of the preferred stock of the Corporation issued at that time as a dividend to all of the common stockholders of the Corporation.

The Commissioner, in determining the income of the Taxpayer for the year 1931 included the par value of such 6,291¼ preferred shares, taken for this purpose as the market value, as a taxable dividend for the year 1931, such par value and such market value being $629,125.

74 Just prior to the time of the declaration of such stock dividend there were outstanding 79,540 shares of preferred stock of the Corporation of the same classification, priority, and preference

as the stock in which said stock dividend was declared and paid, of which preferred stock, prior to such declaration of dividend, the Taxpayer owned 9,642 shares.

All of the said preferred stock of the Corporation was preferred as to dividends in the amount of 6% annually and, in case of dissolution, preferred as to principal. The said preferred stock had no voting rights, all voting rights being vested in the common stock.

On January 1, 1931, shortly prior to the time of the declaration of such stock dividend, the Corporation and its subsidiary companies had an Earned Surplus of $10,422,494.53. The Consolidated Net Earnings of the Corporation and its subsidiaries for 1931 and the immediately preceding years, after the payment of taxes, were as follows:

1931	$2,380,079.34
1930	2,148,901.34
1929	3,393,283.94
1928	3,679,918.31

The Consolidated Net Earnings of the Corporation and its subsidiaries were far more than sufficient to meet the annual dividend requirements of all the preferred stock of the Corporation outstanding, at all times since the organization of the Corporation in 1920, including the said preferred stock of the Corporation distributed in 1931.

75 On December 31, 1931, after the issuance of the said preferred stock of the Corporation as a stock dividend in 1931, the Earned Surplus of the Corporation and its subsidiaries was $8,845,606.58.

On November 28, 1928, there was an increase of 100,000 shares in the authorized preferred stock of the Corporation. Of such increase of 100,000 shares in the authorized preferred stock of the Corporation, 50,000 shares were issued on December 31, 1928, as a stock dividend. On April 27, 1931, 25,000 shares of preferred stock of the Corporation were issued as a stock dividend, of which the Taxpayer received 6,291¼ shares. It is fair to assume from the facts that the said 6,291¼ shares of preferred stock of the Corporation so received by the Taxpayer in 1931, which are the subject of the deficiency tax involved in this proceeding, were a part of the said 100,000 shares of the Corporation, authorized in 1928.

IV. The case was submitted to the Board of Tax Appeals on an Amended Petition, Answer and Agreed Statement of Facts on April 20, 1936, and after due hearing the Board entered on June 27, 1936, a Memorandum Opinion holding, among other things, that such dividend of 6,291¼ shares of preferred stock of the Corporation was not a stock dividend within the meaning of Section 115 (f) of the Revenue Act of 1928, and was subject to tax in 1931.

On July 22, 1936, there was entered herein an Order of the Board of Tax Appeals determining a deficiency against the taxpayer in the sum of $89,941.75 based upon such Memorandum Opinion.

76 Court in Which Review is Sought

V. The Taxpayer, being aggrieved by the Decision of the Board of Tax Appeals, hereby petitions for a review of said Decision by the United States Circuit Court of Appeals for the Second Circuit.

Assignments of Error

VI. The Taxpayer's Assignments of Error are as follows:

1. The Board of Tax Appeals erred in holding and deciding that the said dividend on common stock of the Corporation, paid by the Corporation, in 1931 in shares of its own preferred stock, was taxable.

2. The Board erred in holding and deciding that the said dividend on common stock of the Corporation, paid by the Corporation in 1931 in shares of its own preferred stock, was not a stock dividend within the meaning of Section 115 (f) of the Revenue Act of 1928 and was taxable.

3. The Board erred in not holding and deciding that the said dividend on common stock of the Corporation, paid by the Corporation in shares of its own preferred stock, constituted a non-taxable stock dividend under the Revenue Act of 1928 and other applicable Revenue Acts of the United States.

4. The Board erred in not holding and deciding that the said dividend on common stock of the Corporation, paid by the Cor-
77 poration in shares of its own preferred stock, was exempt from taxation under the Constitution of the United States.

5. The Board erred in not holding and deciding that the said dividend on common stock of the Corporation, paid by the Corporation in shares of its own preferred stock, was exempt as a distribution in pursuance of a Plan of Reorganization of the Corporation within the meaning of the provisions of Section 112 of the Revenue Act of 1928.

6. The Board erred in holding and deciding that there is a deficiency in the taxes of the Taxpayer for 1931 in the sum of $89,841.75, or any other sum.

Wherefore, the Taxpayer petitions that the said decision of the Board of Tax Appeals be reviewed, reversed, and set aside by the United States Circuit Court of Appeals for the Second Circuit; that the Clerk of the United States Board of Tax Appeals be directed to prepare a Transcript of the Record and to transmit and deliver to the Clerk of this Court certified copies of all documents necessary and material to the presentation and consideration of the foregoing Petition for Review and as required by the rules of said Court and the statutes made and provided, and that appropriate

action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

Roger S. Baldwin,
(Sgd) ROGER S. BALDWIN,
Attorney for Petitioner,
120 Broadway, New York, New York.

78 [*Duly sworn to by Roger S. Baldwin, jurat omitted in printing.*]

79 Before United States Board of Tax Appeals
[Title omitted.]

Notice of filing petition for review

Filed Aug. 7, 1936

To HERMAN OLIPHANT, Esq.,
General Counsel for the Department of the Treasury,
Bureau of Internal Revenue, Washington, D. C.:

Please Take Notice that the Petitioner in the above entitled proceeding did, on the 7th day of August, 1936, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a Petition for Review, by the United States Circuit Court of Appeals for the Second Circuit, of the Decision of the Board heretofore rendered in the above-entitled cause. A copy of the Petition for Review and the Assignment of Errors as filed is hereto attached and served upon you.

Dated, at New York City, this 7th day of August, 1936.

Respectfully,

Roger S. Baldwin,
(Signed) ROGER S. BALDWIN,
Attorney for Petitioner,
120 Broadway, New York City, New York.

80 Personal service of the foregoing Notice, together with a copy of the Petition for Review and Assignments of Errors mentioned therein, is hereby acknowledged this 7th day of August, 1936.

Herman Oliphant,
(Signed) HERMAN OLIPHANT,
General Counsel for the Department of the Treasury,
Bureau of Internal Revenue.

Before United States Board of Tax Appeals
[Title omitted.]

Praecipe for transcript of record

Filed Aug. 7, 1936

To the CLERK OF THE UNITED STATES BOARD OF TAX APPEALS,
Washington, D. C.:

You are Hereby Requested to prepare, certify, transmit and
81 deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit a Transcript of the Record, duly certified as correct, and to include in said Transcript the following documents and records or certified copies thereof in the above entitled cause in connection with the Petition for a Review by the said Circuit Court of Appeals for the Second Circuit, heretofore filed herein by the undersigned:

1. The Docket Entries of proceedings herein before the Board.
2. Pleadings before the Board herein:
a. Amended Petition.
b. Answer to Original and Amended Petition.
3. Agreed Statement of Facts filed with the Board on April 20, 1936.
4. Copy of Petitioner's Federal Income Tax Return for 1931.
5. Memorandum Opinion of the Board entered June 27, 1936.
6. Decision of the Board entered on July 22, 1936.
7. Petition for Review, filed by the Petitioner in the above cause, with Notice of Filing Petition for Review, together with Proof of Service of a copy of said Petition for Review and said notice.
8. This Praecipe.

Dated, New York, New York, August 7th, 1936.

Respectfully,

Roger S. Baldwin,
(Signed) ROGER S. BALDWIN,
Attorney for Petitioner.

82 Service of a copy of the above Praecipe is hereby admitted this 7th day of August, 1936.

Herman Oliphant,
(Signed) HERMAN OLIPHANT,
General Counsel for the Department of the Treasury,
Bureau of Internal Revenue,
Attorney for Respondent on Review.

[Clerk's Certificate to foregoing transcript omitted in printing.]

84 In United States Circuit Court of Appeals for the Second Circuit

No. 142. October Term, 1936

Argued Jan. 12, 1937.—Decided Feb. 15, 1937

ANNIE M. PFEIFFER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the Board of Tax Appeals

Before MANTON, L. HAND, and SWAN, Circuit Judges

Petition to review a decision of the Board of Tax Appeals. The taxpayer files the petition. Determination reversed.

Roger S. Baldwin, of New York City, for petitioner.

Robert H. Jackson, Asst. Atty. Gen., and Sewall Key and Morton K. Rothschild, Sp. Assts. to the Atty. Gen., for respondent.

Opinion

MANTON, Circuit Judge: This is a petition to review a decision of the Board of Tax Appeals partially affirming a deficiency determined by the Commissioner of Internal Revenue in the income tax of the petitioner for the year 1931 and fixing such deficiency in the amount of $89,841.75. Wm. R. Warner & Co. Inc.'s original capital stock consisted of 20,000 shares of preferred stock and 3,000 shares of common stock of the par value of $100 per share for both classes. The preferred stock was 6 per cent. cumulative, had no voting power, and was entitled to a preference on liquidation. On various occasions the corporation increased its authorized capital stock and capitalized its earnings by distributing stock dividends. In 1928 and 1931 it made distributions of preferred stock as dividends among its common stockholders which represented earnings and profits accumulated since its incorporation in 1920. Petitioner, as owner of 25,165 shares of common stock, received 12,582 preferred shares in 1928 and 6,291¼ shares in 1931. At the time of these distributions, the fair market value of each share was $100. In 1931 there were no unpaid dividends due on the outstanding preferred stock and the corporation and its subsidiaries had an earned surplus of over eight million dollars. In 1931 the corporation redeemed with cash at par 8,500 preferred shares, 2,000 of which petitioner owned, having received them in the 1928 distribution.

The Commissioner determined a deficiency in petitioner's income tax for 1931, first, because of the failure to include in income the fair

market value, viz, $629,125, of the preferred stock distributed to her in 1931, and, second, because of the failure to include as income $200,000 received from the redemption of the 2,000 preferred shares. The Board upheld the Commissioner's determination as to the first holding that the stock dividend of 1931 was not exempt from taxation by section 115 (f) of the Revenue Act of 1928 (45 Stat. 822, 26 U. S. C. A., § 115 (f) and note). It ruled as to the second that, since the 1928 stock dividend was taxable income as of that year, each share had a basis of $100 in determining gain or loss, and that, since the redemption price was $100 per share, no taxable income existed. The Commissioner has not appealed from this ruling.

85 The dispute centers about the 1931 stock dividend, and the question is whether it is covered by section 115 (f) of the Revenue Act of 1928, 26 U. S. C. A., § 115 (f) and note, reading: "A stock dividend shall not be subject to tax." Does the statute exempt the preferred stock dividend paid upon common stock? A dividend of common stock paid upon preferred stock was held, in Com'r v. Tillotson Mfg. Co., 76 F. (2d) 189 (C. C. A. 6), not to be tax exempt. The taxpayer had sold its preferred stock, and it was argued by the Commissioner that, since the stock dividend was tax free, the original cost basis of the preferred shares should be reduced by allocating a part thereof to the common stock. The court considered that the question depended upon whether or not the dividend was free of tax under the statute. It held that the dividend was subject to tax at the time of its distribution and that therefore the Commissioner's position was untenable. The same issue was presented in Koshland v. Helvering, 298 U. S. 441, 56 S. Ct. 767, 769, 80 L. Ed. 1268, 105 A. L. R. 756, where the court prescinded from the question whether Congress had, in the Revenue Acts of 1926 and 1928 (44 Stat. 9 and 45 Stat. 791), undertaken to tax the dividend upon its receipt. Its position was that such a dividend is constitutionally income and that no departmental regulations could compel the use of "income derived from a capital asset" to reduce cost.

The issue whether a preferred stock dividend on common stock is taxable under the 1928 act was presented in Gowran v. Com'r (C. C. A.), 87 F. (2d) 125, decided December 22, 1936, by the Seventh Circuit. Three months after receiving the preferred stock, the taxpayer sold it to the corporation at $100 per share. The court found no justification for implying a limitation into the comprehensive language of secton 115 (f), 26 U. S. C. A., § 115 (f) and note, which exempts stock dividends without qualification, and held that, since the value of the tax-free dividend at the time of its receipt was $100 per share, no taxable income existed.

In the Koshland Case, supra, the court, because of the grounds upon which it rested its decision, did not find it necessary to decide whether the dividends there considered were exempt from tax under the statute. The language of the opinion, however, indicates that the court considered such dividends to be so exempt, saying:

"Although Eisner v. Macomber [252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570] affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the act of 1921. Soon after the passage of that act, this court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially different from his former interest. Nevertheless the successive statutes and Treasury regulations respecting taxation of stock dividends remained unaltered."

This language indicates clear recognition that the exemption contained in the Revenue Act was broader than required by the decision of Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570, and that it is coextensive with that contained in the regulations.

This fact is amply demonstrated by the background and history of section 115 (f). The Revenue Act of 1913 (38 Stat. 114) imposed an income tax on dividends; Towne v. Eisner, 245 U. S. 418, 38 S. Ct. 158, 62 L. Ed. 372, L. R. A. 1918 D, 254, held that a common stock dividend on common stock was not within the statute; Eisner v. Macomber, supra, held that such a dividend was not income and could not constitutionally be taxed; thereafter the Revenue Act of 1921 (42 Stat. 227) categorically excluded all stock dividends and, though the House and Senate Reports mentioned Eisner v Macomber as a reason (H. R. 350, 67th Congress, 1st Sess., p. 8; Senate Rep. No. 275, 67th Cong. 1st Sess., p. 9), there is not the slightest suggestion that Congress foresaw, or, if it did foresee, that it
86 intended to take advantage of, the fact that a different constitutional rule might apply to one or both types of dividends in stock of a different class from that held by the stockholder. Section 115 (r), 26 U. S. C. A., § 115 (f) and note, flatly declares that "a stock dividend shall not be subject to tax"; and section 115 (g), 26 U. S. C. A., § 115 (g) and note, makes an exception where a corporation cancels or redeems a stock dividend under such circumstances that the dividend is essentially "equivalent to * * * a taxable dividends." Koshland v. Helvering, supra, prompted the insertion in the Revenue Act of 1936, 26 U. S. C. A., § 115 (f), of a provision taxing a stock dividend upon stock of a different class.

The administrative construction [1] of this statute is entitled to great weight. Fawcus Machine Co. v. United States, 282 U. S. 375, 51 S.

[1] 1 T. 1900, C. B. III—1, p. 82 (1924); 1 T. 2449, C. B. VIII—1, p. 101 (1929); 1 T. 2538, C. B. IX—1, p. 144 (1930); article 1548, Reg. 62 (1922), interpreting Revenue Act of 1921.

Ct. 144, 75 L. Ed. 397; Brewster v. Gage, 280 U. S. 327, 50 S. Ct. 115, 74 L. Ed. 457. Both before and after the enactment of the Revenue Act of 1921 (42 Stat. 227), the Treasury Department has considered the term "stock dividend" as meaning any dividend paid by a corporation in its own stock. In Koshland v. Helvering, supra, a series of departmental regulations was overthrown which required an allocation of cost between the dividend stock and the stock on which it was declared. The statutory provisions demanding the deduction of cost in computing capital gain were deemed clear beyond all administrative interpretation and were held not to permit the use of income to reduce cost. If we say that originally the provision exempting stock dividends from taxation was, in view of Eisner v. Macomber, ambiguous, then the Treasury regulations would seem to have acquired the force and effect of law and the meaning of the re-enacted provisions would stand clarified; if we say that the statute was always free from ambiguity, then the regulations merely embodied its clear command.

The appellee argues that the proceeds from the redemption in 1931 of 2,000 shares of preferred stock distributed as a stock dividend in 1928 should be considered either (a) subject to a tax as a capital gain or (b) subject to taxation as the equivalent of the distribution of a taxable dividend pursuant to section 115 (g) of the Revenue Act. The question of taxability as capital gain of the $200,000 or any part thereof was not in issue before or decided by the Board of Tax Appeals. The contention that we have authority to sustain the deficiency pro tanto even though the issue was not raised before the Board nor decided by it nor assigned as error in the petition to this court for a review of the Board's decision is untenable. General Utilities & Operating Co. v. Helvering, 296 U. S. 200, 56 S. Ct. 185, 80 L. Ed. 154; Helvering v. Salvage, 297 U. S. 106, 56 S. Ct. 375, 80 L. Ed. 511. The Board held that this stock dividend redeemed in 1931 at $100 per share was taxable in the year 1928 when received and was therefore not taxable under section 115 (g); that it had a basis for gain or loss of $100 per share; and that therefore there was no taxable income from the redemption. The Commissioner did not file a cross-appeal. By the provisions of section 115 (g) the proceeds of the redemption of the stock can be taxed only if it occurs at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend. Since the Board did not so find, we cannot support this contention. Helvering v. Rankin, 295 U. S. 123, 55 S. Ct. 732, 79 L. Ed. 1343.

Determination reversed.

L. HAND, Circuit Judge, dissenting with opinion.

87 In United States Circuit Court of Appeals for the Second Circuit

No. 142. October Term, 1936

Argued Jan. 12, 1937.—Decided Feb. 15, 1937

ANNIE M. PFEIFFER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the Board of Tax Appeals

Before MANTON, L. HAND, and SWAN, Circuit Judges

Dissenting opinion

L. HAND, Circuit Judge (dissenting): There cannot be any fair doubt that Congress exempted stock dividends only because it supposed that Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570, compelled it to do so. At that time those distinctions had not been suggested which have now limited that ruling to shares of substantially the same kind. If Koshland v. Helvering, 298 U. S. 441, 56 S. Ct. 767, 80 L. Ed. 1268, 105 A. L. R. 756, had followed immediately upon the enactment of section 201 (d) of the Act of 1921 (41 Stat. 228) I should have had little doubt of the propriety—as there could have been none whatever of the desirability—of limiting its scope to such stock dividends as were not income; especially as we are dealing with a tax exemption and doubts go against the taxpayer. Preferred shares issued as a dividend upon common are as much income as common upon preferred, for the question is always whether a substantially new right has been created just as it is in reorganization. Weiss v. Stern, 265 U. S. 242, 44 S. Ct. 490, 68 L. Ed. 1001, 33 A. L. R. 520; Marr v. United States, 268 U. S. 536, 45 S. Ct. 575, 69 L. Ed. 1079. Of course, it is always possible to stick to the literal words, and to insist that "stock dividends" meant every dividend of stock; but that is never a good way to find out what words really mean; whether in a statute, a will, a deed, a contract, or when spoken. There is no way but to reinstate the circumstances in which they were uttered, and discover how much a reasonable person would have understood them to include. If that be done, I should think the result is reasonably clear.

Since 1921 there has, however, been administrative and legislative history with which we must reckon. The first regulation after section 115 (f) was enacted (Article 1548, Regulations 62) declared that "stock issued by a corporation as a dividend does not constitute taxable income * * * but gain may be derived * * * from

the sale of such stock." Since 1925 the form has been: "The issuance of its own stock", but the change is not important. Alongside of this there has always been somewhere in the regulations a provision, implementing as it were, the language I have quoted, and expressly prescribing that the basis must be reduced by the dividend. There has therefore never been any administrative interpretation of section 115 (f), so far as I can find, which did not immediately connect it with this method of calculating the "basis"; unless perhaps Article 115–10 (1) of Regulations 86 and its predecessors may be counted. I do not know how far I should have thought these provisions as a whole conclusive; and it is of no consequence, for Koshland v. Helvering, supra, 298 U. S. 441, 56 S. Ct. 767, 80 L. Ed. 1268, 105 A. L. R. 756, has settled it that so far as they affect the "basis", they have been invalid from the beginning. Thus,
88 the only question now is whether though invalid as to that, they may still be authoritative in interpreting section 115 (f) taken alone. I cannot think that we should blow hot and cold; if the effort indirectly to charge the taxpayer with the new shares under the guise of diminishing his "basis" must break down, any concomitant interpretation as to exemption of the shares, qua income, ought to fall with it. Therefore Koshland v. Helvering, supra, seems to me in substance to have limited the relevant evidence of the intent of Congress to the bare words themselves, stripped of administrative gloss; and the bare words will not serve. I think the Board was right and I can find no convincing evidence that in Horrmann v. Commissioner, 34 B. T. A. 1178, 1180, a majority of its members have changed their minds.

89 In United States Circuit Court of Appeals for the Second Circuit

ANNIE M. PFEIFFER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Filed Feb. 23, 1937

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is reversed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

WM. PARKIN, *Clerk.*

90 [File endorsement omitted.]

91 [Clerk's Certificate to foregoing transcript omitted in printing.]

92 Supreme Court of the United States

Order allowing certiorari

Filed May 17, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is assigned for hearing immediately following No. 887.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File No. 41,435. U. S. Circuit Court of Appeals, Second Circuit. Term No. 895. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. Annie M. Pfeiffer. Petition for a writ of certiorari and exhibit thereto. Filed April 15, 1937. Term No. 895 O. T. 1936.

U. S. GOVERNMENT PRINTING OFFICE: 1937

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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ANNIE M. PFEIFFER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above cause on February 23, 1937, reversing a decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 67) is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 85) is not yet officially reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 23, 1937 (R. 90). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

1. Whether a dividend by a corporation in its own preferred stock, payable to holders of common stock, resulting in the alteration of the pre-existing proportionate interests of the stockholders in the two classes of stock, constitutes taxable income under Section 115 of the Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 8–10.

STATEMENT

The facts, as stipulated (R. 18–62) and as found by the Board of Tax Appeals (R. 67–69), are substantially as follows:

The William R. Warner Corporation, hereinafter called the Corporation, was organized in 1920 under the laws of Delaware, its stock at all times consisting of common and preferred. Each class of stock had a par value of $100 per share, but they were otherwise essentially different. (R. 67.) Dividends upon the preferred stock were never in default (R. 68).

The authorized capital of the corporation was increased several times by capitalizing earnings. (R. 68.) In 1928, the preferred stock was increased from $5,000,000 to $15,000,000, the common stock remaining at $10,000,000, par value. On December 31, 1928, the corporation distributed $5,000,000 par value of preferred stock *pro rata* to common shareholders, and on April 27, 1931, it distributed $2,500,000 shares in a like manner. Each share of preferred had a fair market value of $100 at the date distributed. (R. 68.) Taxpayer received 12,582 shares in the 1928 distribution and 6,291¼ shares in the 1931 distribution. There was no accumulation of unpaid dividends on the preferred stock on April 27, 1931. On December 29, 1931, the corporation redeemed with cash at par 8,500 shares of preferred stock, including 2,000 shares belonging to the taxpayer which she had received in the 1928 distribution. (R. 68.)

In her 1931 return, taxpayer reported a capital gain of $180,100 as resulting from the redemption of the 2,000 shares, deducting a basis computed for stock received as a stock dividend. The Commissioner, in determining the deficiency, eliminated the capital gain, and included as dividends $200,000 representing the redemption and $629,125 representing the dividend in preferred stock. (R. 69.)

The Board of Tax Appeals held that the stock dividend in question was subject to tax at the time of its receipt under Section 115 of the Revenue

Act of 1928. With respect to the redemption of 2,000 shares of stock in 1931, the Board held that since the stock was subject to tax as a dividend in 19 when it was received by the taxpayer, the redemption in 1931 was not essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g). The Board also held that the shares of stock sold in 1931 previously issued as a dividend in 1928 had a cost basis to the taxpayer of $100 each, and consequently that those shares were redeemed without gain or loss to the taxpayer at $100 each in 1931. (R. 69.)

On appeal to the court below taxpayer contended that the stock dividend declared in 1931 was not subject to tax under Section 115 (f) of the Revenue Act of 1928. The Government contended that the stock dividend in question was not within the scope of the term "stock dividend" in Section 115 (f) and therefore was subject to the income tax. In the alternative, it contended that at least $200,000 should be added to the taxpayer's income for 1931 on account of the redemption in that year of stock received by the taxpayer as a dividend in 1928, although it did not file a cross appeal from the decision of the Board. The Government did not ask the lower court to increase the deficiency found by the Board, but merely to uphold the deficiency *pro tanto*. The Government made an additional alternative argument, in the event that the court should reject the above-mentioned contentions, that

the redemption of the preferred stock during the taxable year was essentially equivalent to the distribution of a taxable dividend under Section 115 (g).

The court below held that the dividend in question was not subject to tax under the terms of Section 115 (f) of the Revenue Act of 1928 and refused to pass upon the question of the cost basis of the stock sold during the taxable year and previously issued as a stock dividend in 1928, on the ground that it was not raised before the Board nor decided by the Board, and refused to remand the case to the Board of Tax Appeals for a determination in regard to the application of Section 115 (g) to the circumstances of this case. Judge Learned Hand filed a dissenting opinion in which he said that a stock dividend representing income under the Constitution was subject to tax at the time it was received under Section 115 (f).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividend in question was not subject to tax at the time of its receipt under Section 115 (f) of the Revenue Act of 1928 although it represented income under the Sixteenth Amendment.

2. In failing to hold that Section 115 (f) applies only to stock dividends that do not constitute income under the Sixteenth Amendment.

3. In refusing to pass upon the question of the cost basis of the dividend stock sold during the taxable year and the application of Section 115 (g) to the sale of the dividend stock during the taxable year.

4. In holding that the question of the cost basis of the dividend stock sold during the taxable year was not raised before the Board of Tax Appeals.

5. In refusing to remand the case to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g) to the circumstances of this case.

6. In failing to hold that the cost basis of stock previously issued as a dividend, which might have been taxed as income under the Sixteenth Amendment at the time of receipt, is nothing because it cost the taxpayer nothing.

7. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The court below has decided, with one judge dissenting, that the term "stock dividend" in Section 115 (f) of the Revenue Act of 1928 (*infra*, p. 9) means *any* stock dividend, rather than only such stock dividends as do not constitute income under the Sixteenth Amendment. We submit that in this respect the court erred in deciding a very important question of Federal tax law. Since the same question is presented in No. 887, *Helvering* v. *Gowran*, in which a petition for a writ of certi-

orari to the Circuit Court of Appeals for the Seventh Circuit was filed on April 12, 1937, the Court is respectfully referred to that petition for a full statement of the reasons for granting a review of these cases.

2. We submit that the decision of the court below was also in error in refusing to pass upon and decide in favor of petitioner two alternative arguments, as to which error has been specified at p. 6, *supra*. It does not appear to be necessary to make a full argument as to those errors now.

CONCLUSION

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

APRIL 1937.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791, 822:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock.

The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

(h) *Definition of partial liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its

stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Treasury Regulations 74, relating to the Revenue Act of 1928:

ART. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 29

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ANNIE M. PFEIFFER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 35) is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 43) is reported in 88 F. (2d) 3.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 23, 1937 (R. 48). The petition for certiorari was filed on April 15, 1937,

and granted on May 17, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether a dividend by a corporation in its own preferred stock payable to holders of common, resulting in the alteration of the preexisting proportionate interests of the stockholders in the two classes of stock, constitutes taxable income to the taxpayer under Section 115 of the Revenue Act of 1928.

2. Whether the question of the cost basis of stock sold during the taxable year that had previously been issued as a stock dividend was in fact raised before the Board of Tax Appeals and should have been considered by the lower court.

3. Assuming that the stock dividend in question does not constitute taxable income at the time of its receipt, what is the correct cost basis of the dividend stock?

4. In the event that this Court should hold that the stock dividend in question was not taxable at the time of its receipt and that the cost basis of the stock sold during the taxable year and previously issued as a stock dividend under the circumstances of this case is not zero, whether the case should be remanded to the Board of Tax Appeals to determine whether the redemption of the stock during the taxable year that had previously been issued as a stock dividend was essentially equivalent to the

distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 21–23.

STATEMENT

The facts, as stipulated (R. 9–31) and as found by the Board of Tax Appeals (R. 35–36), are substantially as follows:

The William R. Warner Corporation, hereinafter called the Corporation, was organized in 1920 under the laws of Delaware, its stock at all times consisting of common and preferred. Each class of stock had a par value of $100 per share, but they were otherwise essentially different (R. 35). Dividends upon the preferred stock were never in default (R. 36).

The authorized capital of the corporation was increased several times by the capitalization of earnings. In 1928 the preferred stock was increased from $5,000,000 to $15,000,000, the common stock remaining at $10,000,000, par value. On December 31, 1928, the corporation distributed $5,000,000 par value of preferred stock *pro rata* to common shareholders, and on April 27, 1931, it distributed $2,500,000 shares in a like manner. Each share of preferred had a fair market value of $100 at the date distributed (R. 35). Taxpayer received 12,582 shares in the 1928 distribution and 6,291¼ shares in the 1931 distribution. There was no ac-

cumulation of unpaid dividends on the preferred stock on April 27, 1931. On December 29, 1931, the corporation redeemed with cash at par 8,500 shares of preferred stock, including 2,000 shares belonging to the taxpayer which she had received in the 1928 distribution (R. 36).

In her 1931 return taxpayer reported a capital gain of $180,100 as resulting from the redemption of the 2,000 shares, deducting a basis computed for stock received as a stock dividend. The Commissioner, in determining the deficiency, eliminated the capital gain and included as dividends $200,000 representing the redemption of 2,000 shares of the 1928 dividend and $629,125 representing the 1931 dividend in preferred stock (R. 36).

The Board of Tax Appeals held that the 1931 stock dividend was subject to tax at the time of its receipt under Section 115 of the Revenue Act of 1928. With respect to the redemption of 2,000 shares of stock in 1931, the Board held that since the stock was subject to tax as a dividend in 1928 when it was received by the taxpayer, the redemption in 1931 was not essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g). The Board also held that the 2,000 shares of the 1928 dividend stock sold in 1931 had a cost basis to the taxpayer of $100 each, and consequently that those shares were redeemed without gain or loss to the taxpayer at $100 each in 1931 (R. 36).

On appeal to the court below taxpayer contended that the stock dividend declared in 1931 was not subject to tax under Section 115 (f) of the Revenue Act of 1928. The Government contended that the stock dividend in question was not within the scope of the term "stock dividend" in Section 115 (f) and therefore was subject to the income tax. In the alternative, it contended that at least $200,000 should be added to the taxpayer's income for 1931 on account of the redemption in that year of stock received by the taxpayer as a dividend in 1928. The Government did not ask the lower court to increase the deficiency found by the Board, but merely to uphold the deficiency *pro tanto*. The Government made an additional alternative argument, in the event that the court should reject the above-mentioned alternatives, that the redemption of the preferred stock during the taxable year was essentially equivalent to the distribution of a taxable dividend under Section 115 (g).

The court below held that the 1931 dividend in question was not subject to tax under the terms of Section 115 (f) of the Revenue Act of 1928 and refused to pass upon the question of the cost basis of the stock sold during the taxable year and previously issued as a stock dividend in 1928, on the ground that it was not raised before the Board nor decided by the Board. The court further refused to remand the case to the Board of Tax Appeals for a determination in regard to the application of Section 115 (g) to the circumstances of this case.

Judge Learned Hand dissented in an opinion holding that a stock dividend representing income under the Constitution was subject to tax at the time it was received under Section 115 (f). (R. 43–48.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividend in question was not subject to tax at the time of its receipt under Section 115 (f) of the Revenue Act of 1928 although it represented income under the Sixteenth Amendment.

2. In failing to hold that Section 115 (f) applies only to stock dividends that do not constitute income under the Sixteenth Amendment.

3. In refusing to pass upon the question of the cost basis of the dividend stock sold during the taxable year.

4. In holding that the question of the cost basis of the dividend stock sold during the taxable year was not raised before the Board of Tax Appeals.

5. In failing to hold that the cost basis of stock previously issued as a dividend, which might have been taxed as income under the Sixteenth Amendment at the time of receipt, is nothing because it cost the taxpayer nothing.

6. In refusing to remand the case to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g) to the circumstances of this case.

7. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

1. The dividend in preferred stock paid upon the common stock held by respondent constituted income to respondent within the meaning of the Sixteenth Amendment as settled by this Court in *Koshland* v. *Helvering,* 298 U. S. 441. Such dividend was not exempt under Section 115 (f) of the Revenue Act, which provides that a stock dividend shall not be subject to tax.

2. Since a question of the cost basis of the dividend stock sold during the taxable year was in fact raised before the Board of Tax Appeals, and was advanced in this form in the court below only to sustain a part of the Board's determination, it should have been considered by the lower court.

3. If this Court should decide that the stock dividend which the taxpayer received in 1931 was not taxable at the time of its receipt, we submit as an alternative argument that when the taxpayer sold 2,000 shares of preferred stock in 1931 which she had received as a dividend in 1928, the entire proceeds of the sale represented taxable gain, since the cost basis is zero.

4. If this Court should decide that the stock dividend was not taxable at the time of its receipt and that the cost basis of the dividend stock is not zero, we submit that the case should be remanded to the Board of Tax Appeals to determine whether the redemption of the preferred stock in 1931, previously issued as a dividend in 1928, was made at such

time and in such manner as to be essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928. Since the Board's decision that the section was inapplicable was based upon the express assumption that the stock dividend was taxable at the time of its receipt, and the lower court reversed the Board and held that the stock dividend was not taxable at the time of its receipt, the lower court's action in refusing to remand the case was error.

ARGUMENT

I

A DIVIDEND BY A CORPORATION IN ITS OWN PREFERRED STOCK PAYABLE TO HOLDERS OF COMMON CONSTITUTES TAXABLE INCOME TO THE TAXPAYER UNDER SECTION 115 OF THE REVENUE ACT OF 1928

1. The petitioner's brief in *Helvering* v. *Gowran,* No. 27, October Term, 1937, develops, at pp. 10–11, our view that the decision of *Koshland* v. *Helvering,* 298 U. S. 441, establishes that the payment of a dividend in stock different from that on which it was declared constitutes the receipt of income under the Sixteenth Amendment, at least when the proportionate interest of the stockholder in the corporation is changed in nature or in amount. It is clear that this conclusion is applicable here, and that the stock dividends received by the respondent were income under the Sixteenth Amendment.

The common stock held by respondent prior to the 1931 dividend was voting stock of $100 par value. No dividends could be paid thereon until all dividends, present and in arrears, had been paid on preferred. In liquidation, distributions on the common were subject to prior payment of the par value of the preferred plus unpaid dividends accrued. On the other hand, the $100 par value preferred stock received by respondent as a dividend was redeemable at $105 plus unpaid dividends accrued, was non-voting, and was entitled to a cumulative dividend of six percent and prior payment on liquidation (R. 17–18, 35).

Just prior to the 1931 dividend, the corporation's outstanding stock amounted to 100,000 common shares of which respondent held 25,165 shares, and 79,540 preferred shares of which respondent held 9,642 shares.[1] The total dividend received by common stockholders consisted of 25,000 shares of preferred, of which respondent received 6,291 shares.[2] Thus respondent before the dividend held her common stock subject to asset preferences of 79,540 shares of preferred, totalling $7,954,000, and an annual preferred dividend charge of $477,240, but after the dividend held her shares of common stock

[1] The common and preferred stockholders were substantially different groups. Despite preferred stock dividends paid on common in 1925, 1926, and 1928 (R. 13–14), the common stockholders prior to the dividend in 1931 owned only approximately half of the preferred outstanding (R. 15).

[2] Fractions are omitted in this discussion.

subject to asset preferences of 104,540 shares of preferred, totalling $10,454,000, and an annual preferred dividend charge of $627,240. Cf. *Marr* v. *United States,* 268 U. S. 536, 541. Moreover, in addition to the change in the nature of the proportional interest in the net assets and income of the corporation represented by the common shares, respondent's proportional interest in the equities in net assets and income attributable to preferred was materially altered. Before the dividend, respondent's 9,642 shares of preferred constituted 12 percent of the outstanding preferred, and gave respondent an interest in net assets of $964,200 and an annual cumulative right to $57,852 in dividends subject to no priorities. But after the dividend, respondent held 15,933 shares of preferred stock which constituted 15 percent of the preferred outstanding after the dividend, and which gave respondent an interest in net assets of $1,593,300 and an annual cumulative right to $95,598 in dividends subject to no priorities. So, too, as a result of the dividend the proportional interests of the common and preferred stockholder groups were materially altered. Whereas before the dividend common stockholders owned but fifty-one percent of the preferred stock, and the equities in assets and income attributable thereto, after the dividend the common stockholders owned sixty-two percent of the stock and equities. The preferred stock dividend received by the respondent was thus income within

the meaning of the Sixteenth Amendment as settled by the *Koshland* decision.

2. The question becomes one of whether the dividend received by respondent, which clearly constituted income within the meaning of the Sixteenth Amendment, was taxed by Congress at the time of its receipt or was exempt within the meaning of Section 115 (f) of the Revenue Act of 1928. The Government's argument on this point is set forth in full at pp. 14–24 of our brief in *Helvering* v. *Gowran,* No. 21, October Term, 1937, to which the Court is respectfully referred.

II

THE QUESTION OF THE COST BASIS OF THE DIVIDEND STOCK SOLD DURING THE TAXABLE YEAR SHOULD HAVE BEEN CONSIDERED BY THE LOWER COURT

The court below refused to consider the argument of the Government that, if the 1931 dividends were not taxable as ordinary income, then the cost basis on the 1931 sale of preferred stock received as a dividend in 1928 was zero. This was because the court was of the view that the question had not been raised before the Board (R. 46). Before discussing the question on the merits, we shall show that the question was in fact raised before the Board and should have been considered by the court below.

The deficiency notice which the Commissioner sent the taxpayer in December 1935, and which

was attached to the petition filed in the Board of Tax Appeals, contains a statement showing adjustments to net income. Schedule 1 shows under the heading of "Unallowable deductions and additional income" an item of "Preferred stock redeemed" in the amount of $200,000, and another representing "Dividend in preferred stock" in the amount of $629,125, giving a total of $829,125. From this sum is deducted under the heading of "Nontaxable income and additional deductions" an item of "Capital gain" in the amount of $180,100 (R. 6–7).

Paragraph (j) of the Petition for Review alleges that the taxpayer included in her return for the year 1931 the sum of $180,100 as capital gain from the sale of 2,000 shares of preferred stock sold to the Warner Corporation during the year 1931, and that she paid a capital gain tax thereon in the amount of $22,512.50. The taxpayer expressly petitioned the Board of Tax Appeals to relieve her from the deficiency in tax resulting from treating the proceeds of the sale of 2,000 shares of preferred stock received by her in the year 1928 as a taxable dividend for the year 1931; and in the event that a deficiency in tax should be found by reason of treating the 6,291¼ shares of preferred stock as a taxable dividend, that the amount of the deficiency should be reduced by the elimination of the capital gain tax on the 2,000 shares of preferred stock sold to the Warner Corporation in the year 1931 (R. 5).

The Board of Tax Appeals found that the taxpayer reported in her 1931 return a capital gain of $180,100 as resulting from the redemption of the 2,000 shares after deducting a basis computed for stock received as a stock dividend. The Board also found that the Commissioner, in determining the deficiency, eliminated the capital gain and included as dividends $200,000 representing the redemption (R. 36). In its opinion the Board said (R. 36):

> The Commissioner held that the redemption of the 2,000 shares in 1931 was at such time and in such manner as to be substantially equivalent to a taxable dividend in 1931, within the meaning of section 115 (g) of the Revenue Act of 1928. He erred in this since the distribution was subject to tax as a dividend in 1928 (see cases above cited). Thereafter the shares had a basis for gain or loss to the petitioner of $100 each, and they were redeemed without gain or loss to the petitioner at $100 each in 1931.

Hence the question of the cost basis of the 2,000 shares of stock redeemed in 1931 was clearly in issue before the Board of Tax Appeals, and was passed upon by the Board, which determined a different basis from that adopted by the taxpayer.

Furthermore, taxpayer's return with respect to the 1931 stock dividend and the capital gain on the redemption of the 1928 dividend stock purported to follow Treasury Regulations in effect at the time. The deficiency notice was issued after

the case of *Tillotson Manufacturing Co.* v. *Commissioner,* 27 B. T. A. 913, affirmed 76 F. (2d) 189 (C. C. A. 6th), cast substantial doubt upon the validity of the Treasury Regulations. (This doubt was confirmed in the decision of this Court in the *Koshland* case.) Accordingly, the Commissioner sought to tax the 1931 stock dividend as income when received. Having succeeded upon that point before the Board, the Commissioner could no longer maintain that the substantially similar 1928 stock dividend was taxable upon redemption under Section 115 (g) because that dividend, like the 1931 dividend, was not within the exemption of Section 115 (f) and was taxable at the time of its receipt. The Board then reasoned that since the 1928 dividend was not exempt from tax at the time of receipt, its basis upon redemption would be $100 per share. It is apparent that at all times in this proceeding the questions of exemption of dividend shares and their cost basis have been interrelated and each was inherent in the appeal. The two questions of exemption and basis have always been tied together in the Treasury Regulations since the decision of this Court in *Eisner* v. *Macomber,* 252 U. S. 189, and the provision of the Revenue Act of 1921 to the effect that a stock dividend shall not be subject to tax. See *Miles* v. *Safe Deposit Co.,* 259 U. S. 247, and the dissenting opinion of Judge Learned Hand in the instant case (R. 47–48).

The situation is that the Board has determined a deficiency against the taxpayer of $89,841.75 (R. 37) and in so doing has considered the question of the basis for capital gains. In this case, as in *Helvering* v. *Gowran,* No. 27, October Term, 1937 (see Brief for Petitioner, pp. 28–29), there was no occasion for the Commissioner to urge an alternative theory before the Board which would sustain only a part of this deficiency.[3] There was no occasion for him to take a cross-appeal, since his alternative theory was incompatible with the Board's determination that the 1931 dividend was taxable income, and would result in a smaller deficiency. A party must show injury before he can appeal from a decision.

The issue before the court below was the correctness of the deficiency entered by the Board. The Commissioner did not complain of the decision of the Board. He sought only to urge in partial support of its determination a theory which could be advanced only if the Board were held erroneously to have accepted the Commissioner's main argument. In this case, as in *Helvering* v. *Gow-*

[3] The corporation in 1931 redeemed 2,000 shares distributed to the taxpayer in 1928 (R. 36). A tax on capital gains thus realized would plainly be much less than the incompatible tax on income represented by the further dividend of 6,291¼ shares received by the taxpayer in 1931 (R. 36).

ran, there is involved only a question of law; there is no relevant question of fact which has not been found by the Board. Similarly, there is no element of surprise or injustice to the party seeking review by the Circuit Court of Appeals. There is no attempt to secure a reversal of the Board on an issue not presented to it. Compare *General Utilities Co.* v. *Helvering,* 296 U. S. 200; *Helvering* v. *Salvage,* 297 U. S. 106. This case seems well within the rule which allows the respondent to advance any argument in support of the judgment below. *United States* v. *American Express Ry. Co.,* 265 U. S. 425, 435–436; *Langnes* v. *Green,* 282 U. S. 531, 538–539; *Stelos Co.* v. *Hosiery Corp.,* 295 U. S. 237, 239.

Accordingly, we submit that the court below should have considered the issue as to the proper cost basis of the 1928 preferred stock upon its redemption in 1931.

III

ASSUMING THAT THE STOCK DIVIDEND IN THIS CASE DOES NOT CONSTITUTE TAXABLE INCOME AT THE TIME OF ITS RECEIPT, THE CORRECT COST BASIS OF SUCH STOCK IS ZERO

If this Court should decide that the dividend in preferred stock was not taxable at the time of its receipt in April 1931, we submit that at least $200,000 should be added to the taxpayer's income for

1931 on account of the redemption in that year of stock received as a dividend in 1928.

Here the 1928 preferred stock dividend, just as the not essentially different 1931 dividend, constituted income to respondent within the meaning of the Sixteenth Amendment. See pp. 8–11, *supra*. But if such dividend stock, in the opinion of this Court, was nevertheless exempt from tax under Section 115 (f), then the proper basis for such stock is cost, and the cost here is zero. This point is fully argued at pp. 25–27 of our brief in *Helvering* v. *Gowran,* No. 27, October Term, 1937, to which the Court is respectfully referred.

IV

IF THIS COURT SHOULD DECIDE POINTS I, AND EITHER II OR III ADVERSELY TO THE GOVERNMENT, THE CASE SHOULD BE REMANDED TO THE BOARD OF TAX APPEALS TO DETERMINE THE APPLICATION OF SECTION 115 (g) TO THE CIRCUMSTANCES OF THIS CASE

If this Court should decide against the petitioner on Point I, and on either of Points II or III, we submit that the case should be remanded to the Board of Tax Appeals to determine whether redemption of the preferred stock was made at such time and in such manner as to be essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928, *infra,* p. 22. In the year 1931 the corporation in

this case redeemed 2,000 shares of preferred stock belonging to the taxpayer which had been issued as a stock dividend in the year 1928. Section 115 (g) of the Revenue Act of 1928, *infra,* p. 22, provides that if a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

The question to be decided under Section 115 (g) is essentially one of fact dependent upon the circumstances in each case. *Commissioner* v. *Babson,* 70 F. (2d) 304 (C. C. A. 7th), certiorari denied, 293 U. S. 571; *Hyman* v. *Helvering,* 71 F. (2d) 342 (App. D. C.), certiorari denied, 293 U. S. 570; *Randolph* v. *Commissioner,* 76 F. (2d) 472, 476 (C. C. A. 8th), certiorari denied, 296 U. S. 599; *McGuire* v. *Commissioner,* 84 F. (2d) 431 (C. C. A. 7th), certiorari denied, 299 U. S. 591. It was probably for this reason that the lower court refused to disturb the opinion of the Board as indicated by its citation of *Helvering* v. *Rankin,* 295 U. S. 123. But the Board of Tax Appeals expressly based its conclusion that the redemption of the 2,000 shares in 1931 was not essentially equivalent

to a dividend under Section 115 (g) upon the ground that the distribution of the stock dividend was subject to tax as a dividend in 1928 (R. 36). Since the lower court reversed the Board's decision and held that the stock dividends in question were not subject to tax at the time they were received, the question as to the application of Section 115 (g) to the facts and circumstances of the redemption can be determined only if the case be remanded to the Board. To refuse to do so, as the lower court did,[4] was arbitrary.

CONCLUSION

The lower court erroneously construed the term "stock dividend" in subdivision (f) of Section 115 of the Revenue Act of 1928 to include any stock dividend, whether it represented income under the Constitution or not. If, however, this Court should decide that the stock dividend was not taxable at the time of receipt, the cost basis of the dividend stock is zero. If this Court decides against the petitioner on both of these grounds, the case should be remanded to the Board of Tax

[4] It is possible that the opinion of the court below (R. 46) may be interpreted to mean merely that the court itself would not hold Section 115 (g) applicable without a decision of the Board on the factual questions, and that its mandate of reversal was intended to permit the Board to consider this question on further proceedings. If this be the correct interpretation, which we think unlikely, we have no complaint as to this action of the court below but ask instead that the matter be clarified.

Appeals to pass upon the application of Section 115 (g).

Respectfully submitted.

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OCTOBER 1937.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies), means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized

only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

(h) *Definition of partial liquidation.*—As used in this section, the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Treasury Regulations 74, relating to the Revenue Act of 1928:

> ART. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

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IN THE

Supreme Court of the United States

October Term, 1936

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

ANNIE M. PFEIFFER.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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IN THE

Supreme Court of the United States

October Term, 1936

No. 895

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

ANNIE M. PFEIFFER.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 67) is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 85) is reported in 88 Fed. (2d) 3.

Questions Presented.

I. Is a dividend by a corporation in its own Preferred Stock, paid to holders of Common Stock when there were other shares of Preferred Stock of the same classification outstanding a part of which were held by others than the common stockholders, a "stock dividend" within the meaning of Section 115 (f) of the Revenue Act of 1928?

II. Is such a Preferred Stock Dividend taxable under the Sixteenth Amendment to the Constitution?

III. Should the Circuit Court of Appeals have passed upon the question of the cost basis of the Dividend Stock sold during the taxable year?

IV. If the Circuit Court of Appeals should have passed upon the cost basis of the Dividend Stock, what is the correct cost basis, assuming that such dividend was not subject to tax under the Statute at the time of its receipt?

V. Should the Circuit Court of Appeals have held that the proceeds from the redemption of the Dividend Stock were taxable under Section 115 (g)?

Statutes Involved.

The Statutes involved are contained in the Appendix.

Statement.

This controversy arises out of a proposed deficiency in Federal Income Tax of the Responding Taxpayer for the year 1931.

William R. Warner Corporation, hereinafter called the "Corporation", was organized in 1920 under the Laws of Delaware, its stock at all times consisting of Common and non-voting Preferred. Each class of stock had a par value of $100 per share (R. 20). Dividends upon the Preferred Stock were never in default (R. 31). The authorized Capital Stock of the Corporation was increased several times by capitalizing its earnings (R. 22, 24, 26). In 1928, the Corporation was again recapitalized and the authorized Capital Stock was increased *from* $15,000,000, consisting

of $5,000,000 of Preferred Stock and $10,000,000 of Common Stock, *to* $25,000,000, consisting of $15,000,000 of Preferred Stock and $10,000,000 of Common Stock,—an increase of $10,000,000 in the Preferred Stock (R. 27).

In 1928 the Corporation issued and distributed 50,000 shares of the Preferred Stock, so authorized, as a dividend to the Common Stockholders of the Corporation in the ratio of one share of Preferred Stock to each two shares of Common Stock (R. 27, 52).

In 1931 the Corporation issued and distributed 25,000 shares of Preferred Stock of the Corporation to the Common Stockholders as a stock dividend in the ratio of one share of Preferred Stock to each four shares of Common Stock (R. 28, 55). At the time this Stock Dividend was declared, 79,540 shares of Preferred Stock were outstanding, of which 40,727 shares were owned by the Common Stockholders (R. 29). The Taxpayer was the owner of 25,165 shares of Common Stock and 9,642 shares of Preferred Stock and received, as her share of the 1931 distribution, 6,291¼ shares of Preferred Stock of the Corporation (R. 29). The market value of the shares so received was $629,125,—their par value (R. 32).

Throughout these several recapitalizations, including the recapitalizations of 1928 and 1931, the terms, provisions and priorities of the two classes of Stock remained unchanged (R. 27). The earnings of the Corporation itself, as well as the consolidated net earnings of the Corporation and its subsidiaries, were far more than sufficient to pay the dividends on the Preferred Stock of the Corporation at any time outstanding (R. 62). Cash dividends were paid by the Corporation, as called for by its Preferred Stock, and large additional cash dividends were paid on the Common Stock during each of the years 1920 to 1931, inclusive

(R. 62). The earned surplus of the Corporation and its subsidiaries on December 31, 1931, after the payment of the Stock Dividend in dispute, was $8,845,000 (R. 59).

In 1931 the Corporation redeemed with cash at par, 8,500 shares of its Preferred Stock, including 2,000 shares belonging to the Taxpayer, which were a part of the Stock Dividend which she had received in 1928 (R. 32).

In her 1931 Income Tax Return the Taxpayer did not report as income the 6,291¼ shares of Preferred Stock received by her as a Stock Dividend. The Commissioner, in determining the deficiency, included as taxable income the sum of $629,125, representing the value of this Stock Dividend (R. 13).

In her 1931 Income Tax Return the Taxpayer reported a capital gain of $180,100, as having resulted from the redemption of the 2,000 shares of Preferred Stock—a part of the shares issued to her in 1928 as a Stock Dividend—the gain having been determined in accordance with Regulations of the Treasury Department then effective, and paid a tax of $22,512.50 on such capital gain (R. 33).

The Commissioner, in determining the deficiency, eliminated the capital gain of $180,100 and included as a taxable dividend the sum of $200,000 received by the Taxpayer from such redemption (R. 13).

The Board of Tax Appeals held that the dividend paid in Preferred Stock in 1931 was not a "stock dividend" within the meaning of Section 115 (f) of the Revenue Act of 1928, and that, therefore, such dividend was a taxable dividend. With respect to the 2,000 shares of stock issued in 1928 and redeemed in 1931, the Board held that, since in its opinion the Stock Dividend was subject to tax as income when received in 1928, the redemption in 1931 was not essentially equivalent to the distribution of a taxable divi-

dend within the meaning of Section 115 (g). The Board explained that the shares of stock sold in 1931, being, as it held, income in 1928, had a cost basis to the Taxpayer of $100 per share, and consequently that the redemption of those shares in 1931 resulted in no gain to the Taxpayer in 1931 (R. 69).

On appeal by the Taxpayer to the Circuit Court of Appeals the Government contended that the Stock Dividend in question was not a "stock dividend" within the meaning of Section 115 (f) of the Statute and, therefore, was subject to income tax. This was the only issue raised on the appeal, since the Government did not file a cross appeal from the Board's decision on the question involving the application of Section 115 (g). Notwithstanding the Government's failure to file a cross appeal, it made the two following alternative contentions in its brief and oral argument before the Circuit Court of Appeals.

(1) That the Taxpayer realized a capital gain of $200,000 as a result of the redemption of the 2,000 shares of Preferred Stock which she had received as a Stock Dividend in 1928, basing this contention upon the proposition that this Stock Dividend in her hands had a basis of zero. This would result in a capital gain of $200,000 to the Taxpayer instead of $180,100, the amount originally reported by her in her Return. This contention was not made by the Commissioner in his 90-Day Letter or in his Answer to the Petition before the Board and was not urged before the Board nor raised by cross appeal to the Circuit Court of Appeals.

(2) That the redemption in 1931 of a portion of the Preferred Stock Dividend was taxable as the essential equivalent to the distribution of a taxable dividend under Section

115 (g), in the event that the Court should hold the basis of the redeemed Stock Dividend not to be zero, as contended in (1) above.

This alternative contention, if allowed, would result in adding $200,000 to the Taxpayer's income for 1931 in the form of dividend income. This contention was not raised by cross appeal.

The Circuit Court of Appeals held that the Preferred Stock Dividend received in 1931 was not subject to tax under the terms of Section 115 (f) of the Revenue Act of 1928. The Circuit Court of Appeals refused to consider a deficiency *pro tanto* upon the theory that the cost basis of the stock sold to the Corporation by the Taxpayer during the taxable year, and previously received as a Stock Dividend in 1928, was zero, because this point was not raised before nor decided by the Board of Tax Appeals. The Circuit Court of Appeals further refused to consider whether the redemption of the Preferred Stock in 1931 was the equivalent of the distribution of a taxable dividend under Section 115 (g), because the Government did not file a cross appeal from the decision of the Board of Tax Appeals, and further because the Board of Tax Appeals did not find that the redemption of the Preferred Stock in question occurred at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend under the provisions of Section 115 (g).

Reason for Not Granting the Writ.

The questions presented do not warrant further consideration by this Court.

Argument on Questions Presented.

I.

Is a dividend by a corporation in its own Preferred Stock, paid to holders of Common Stock when there were other shares of Preferred Stock of the same classification outstanding a part of which were held by others than the common stockholders, a "stock dividend" within the meaning of Section 115 (f) of the Revenue Act of 1928?

Section 115(f) of the Revenue Act of 1928 provides:

"A stock dividend shall not be subject to tax."

The question here presented involves the construction of the above quoted section. It was determined in the negative and in favor of the taxpayers by the Circuit Court of Appeals for the Second Circuit on February 15, 1937 in this case and by the Circuit Court of Appeals for the Seventh Circuit on December 22, 1936 in the case of *Gowran* v. *Commissioner* (87 Fed. (2) 125).

There has been no conflict in the Circuit Courts of Appeals on this question in any case where the Government was attempting to tax stock dividends as income.

The question was first suggested in *Tillotson Manufacturing Company* v. *Commissioner* (27 B. T. A. 913), decided in 1933, but was raised by the taxpayer, not by the Government. The fundamental question in that case was not the taxability of a stock dividend under Section 115 (f) of the Revenue Act, but the proper cost basis for determining capital gain upon the sale of Preferred Stock upon which a Common Stock Dividend had been paid. The Board of Tax Appeals in the *Tillotson* case, reversing the Commissioner, and sustaining the taxpayer, held that a dividend paid by a corporation in its Common Stock on its Preferred

Stock did not diminish the basis of the Preferred Stock. The reason given by the Board for this decision was that the Common Stock Dividend was not exempt from taxation either under the Statute or under the Constitution, and that, therefore, such Common Stock Dividend constituted taxable "income", and so left the cost basis of the Preferred Stock undiminished.

On appeal, the Circuit Court of Appeals for the Sixth Circuit affirmed, stating that the stock dividend Constitutionally was not exempt from taxation. (76 Fed. (2d) 189.) This was in 1935. The decision of that Court, while referring to the Statutory exemption, does not seem to have decided the case on that point.

As will below appear, the result reached by the Board of Tax Appeals and by the Circuit Court of Appeals in the *Tillotson* case was later approved by this Court but not upon the principle that the Stock Dividends were taxable under the Statute when received.

The case of *Koshland v. Helvering* (81 Fed. (2d) 641) was the next case after the *Tillotson* case in the series of Stock Dividend cases. That case was decided on January 20, 1936 by the Circuit Court of Appeals for the Ninth Circuit. That Court did not consider the question of Constitutional exemption but held, reversing the Board, that a common stock dividend on Preferred Stock was specifically exempt from tax under the Statute (Section 115 (f)) and approved the action of the Commissioner in adjusting the cost basis of the Preferred Stock upon which the Stock Dividend was paid.

On Writ of Certiorari in the *Koshland* case (298 U. S. 441) this Court on May 18, 1936 held as follows:

1. That a dividend on Preferred Stock paid in Common Stock of a corporation is "income" under the Sixteenth

Amendment to the Constitution, *whether or not Congress has taxed it as of the time of its receipt.*

2. That where a taxpayer purchased non-voting cumulative Preferred Stock of a corporation upon which a dividend was subsequently paid in Common Stock, and thereafter disposed of such Preferred Stock, there should be no apportionment of cost between Preferred and Common Stock for the purpose of determining gain or loss.

The reasoning of the opinion of this Court in the *Koshland* case was that Congress, having expressly declared in computing capital gain that the "cost" of the asset disposed of shall be deducted from the selling price, the Secretary of the Treasury was without power by Regulation "to add a provision that income derived from the capital asset shall be used to reduce cost." The question of whether or not Congress had exempted such a stock dividend from taxation was not expressly decided. That this Court, however considered such a Stock Dividend to be exempt under the Statute may be fairly inferred from the following language used by this Court in its opinion:

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921. Soon after the passage of that act, this Court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially different from his

former interest. *Nevertheless the successive statutes and Treasury regulations respecting taxation of stock dividends remained unaltered.*" (Italics supplied by us.)

The Circuit Court of Appeals for the Second Circuit in the *Pfeiffer* case in commenting upon the above portion of the opinion of this Court stated:

> "This language indicates clear recognition that the exemption contained in the Revenue Act was broader than required by the decision of *Eisner* v. *Macomber,* 252 U. S. 189, and that it is coextensive with that contained in the regulations.
>
> "This fact is amply demonstrated by the background and history of § 115 (f)."

The Circuit Court of Appeals for the Seventh Circuit in the *Gowran* case, and the Circuit Court of Appeals for the Second Circuit in this, the *Pfeiffer* case, both followed what they believed to be the conclusion of this Court as expressed in its opinion in the *Koshland* case.

On October 31, 1936, in the case of *August Horrmann,* 34 B. T. A. 1178, the Board of Tax Appeals, which was the first to raise the question of the taxability of stock dividends under the Statute when received, and the only judicial or semi-judicial branch of the Government which has attempted to tax stock dividends when received, would seem to have definitely reversed its opinion. The Board there said:

> "Whether we are right or wrong in our interpretation of the *Koshland* case, and whether or not the preferred stock dividend of 1922 was income, we are of the opinion that it was not taxable to the stockholders. Of course, if it was a stock dividend, within the compass of *Eisner* v. *MacComber,* it was not income under the Sixteenth Amendment; if it was income, as in the *Koshland* case, it was nevertheless

a stock dividend which was specifically exempt from tax under Section 201 (d) of the Revenue Act of 1921.

This exemption has been of long standing as pointed out in the opinion in the *Koshland* case. All of the Revenue Acts from 1921 to 1934, inclusive, have specifically provided for the exemption and the Treasury regulations over an equally long period of time have broadly held stock dividends nontaxable."

The following propositions would seem to be well established:

1. A dividend paid in the stock of a corporation declaring the dividend is, by common definition, a stock dividend.

2. The Treasury Department, in its official Regulations and Treasury Decisions, and Congress, in its previous Acts, for fourteen years uniformly used the term "stock dividend" as meaning a dividend paid by a corporation in shares of its own stock, although paid in stock of a character different from the stock on which the stock dividend was paid.

3. The Administrative construction of a Statute is entitled to great weight.

4. Taxpayers had a right to rely upon a normal interpretation of the language of a Statute and upon the Administrative construction thereof.

5. Successive reenactments by Congress of a Statutory provision exempting stock dividends from taxation, after such uniform practice on the part of the Treasury Department, are persuasive evidence of Legislative approval of the Administrative construction of such provisions.

6. Section 115 (g) of the Revenue Act of 1928 and the corresponding Sections of other Acts provide for taxation under certain circumstances of the proceeds from the redemption of stock issued as a Stock Dividend. This provision of the Statutes shows that Congress understood that such dividends were not taxable when received, and intended that such dividends should not be taxable when received.

The Circuit Courts of Appeals for three Circuits—the Ninth, the Seventh and the Second—have held that stock dividends of the character involved in this case are not subject to tax under the Statute. The Board of Tax Appeals, we believe, has now reached the same conclusion. This Court, in the *Koshland* case, has already indicated that this was its own view.

These decisions conform to a long and definitely established legislative and administrative policy and confirm the correctness of the position which the Government originally took, and uniformly and continuously has taken before the Board of Tax Appeals, the Circuit Courts of Appeals and this Court, in all cases which preceded the *Gowran* and *Pfeiffer* cases.

The law on this point seems now to be settled. There is no reason, therefore, why this Court should be asked to review the question further.

A reversal of this long-established policy of the Government would result in the infliction of tremendous hardships upon taxpayers who, in shaping their corporate financial policies, have relied for many years upon the plain language of the Statute and upon the Government's own interpretation and enforcement of the Statute.

There is no Constitutional question involved in the question here presented.

Since the decision in the *Koshland* case, in May, 1936, Congress changed the law with respect to the taxation of stock dividends, by an amendment enacted on June 22, 1936, contained in Section 115 (f) (1) of the Revenue Act of 1936, which made stock dividends in the future taxable to the extent that they constitute "income" within the meaning of the Sixteenth Amendment to the Constitution.

It is submitted that this amendment indicates that Congress did not intend to tax stock dividends under the previous statute or is convinced that it did not do so. Thus, beginning with the year 1936, the question of statutory exemption of stock dividends will not arise, and revenue will be collected accordingly.

II.

Is such a Preferred Stock Dividend taxable under the Sixteenth Amendment to the Constitution?

The Circuit Court of Appeals for the Second Circuit in this case did not express an opinion on this point.

The Circuit Court of Appeals for the Seventh Circuit apparently assumed in the *Gowran* case that, by reason of the decision of this Court in the *Koshland* case, the stock dividend in the *Gowran* case must be held to be income which Congress, under the Constitution, might tax.

If this Court agrees that a stock dividend is not subject to tax under the Statute, the taxability of such income under the Constitution need not be decided here, at least so far as concerns the taxability of the Stock Dividend distribu-

tion. If, however, this Court should not agree with the Circuit Court of Appeals that a Stock Dividend is not subject to tax under the Statute, then the question of taxability under the Constitution will be an issue and should be argued before this Court.

A dividend of Preferred Stock on Common Stock, such as was paid in this case, may present a very different situation from that which existed in the *Koshland* case, where there was a dividend of Common Stock paid upon Preferred Stock. It would not seem, however, that this question should be argued on this application.

III.

Should the Circuit Court of Appeals have passed upon the question of the cost basis of the Dividend Stock sold during the taxable year?

The question of the taxability as capital gain of the $200,000 or any part thereof, received by the Taxpayer from the redemption of the 2,000 shares of Preferred Stock received as a Stock Dividend during the year 1928, was not an issue before or decided by the Board of Tax Appeals.

This Court has definitely held in the case of *General Utilities and Operating Company* v. *Helvering*, 296 U. S. 200, that a Circuit Court of Appeals is without authority to decide a question not at issue before or decided by the Board of Tax Appeals. This Court reached the same conclusion in the case of *Helvering* v. *Salvage*, 297 U. S. 106. The Circuit Court of Appeals, therefore, should not have considered or decided in this case the question of cost basis raised by the Government for the first time in its brief submitted to such Court.

IV.

If the Circuit Court of Appeals should have passed upon the cost basis of the Dividend Stock what is the correct cost basis, assuming that such dividend was not subject to tax under the Statute at the time of its receipt?

It was decided, in favor of the taxpayer, by the Circuit Court of Appeals for the Seventh Circuit in the *Gowran* case, that the cost basis of a Preferred Stock Dividend paid on Common Stock was the fair market value of such Preferred Stock when received, and not, as claimed there and here by the Government, zero. In the *Gowran* case a Petition for a Writ of Certiorari was filed in this Court on April 12, 1937. It is assumed that such Petition will be considered at the same time as the Petition in this case. As we will file an *amicus curiae* brief in opposition to the granting of a Writ of Certiorari in the *Gowran* case, in which brief the question above presented will be discussed and reasons given for not granting the Writ, we refrain from discussing such question here at length. We respectfully refer the Court to our brief in the *Gowran* case, so far as the above question is concerned.

V.

Should the Circuit Court of Appeals have held that the proceeds from the redemption of the dividend stock in this case were taxable under Section 115 (g)?

The Board of Tax Appeals held that because the Stock redeemed in 1931 was, as it thought, taxable in 1928, when received, the proceeds from the redemption were not sub-

ject to taxation in 1931 under Section 115 (g) of the Revenue Act.

The Circuit Court of Appeals reversed the Board by holding that a stock dividend is not subject to tax under the Statute when received. The Circuit Court further held, however, that the proceeds from the redemption of stock can be taxed as a dividend under the provisions of Section 115 (g) *only* if the redemption occurs at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend and, as the Board did not so find, the Circuit Court refused to sustain the contention of the Government that the redemption in question was the equivalent of a taxable dividend.

The Board did not find as a matter of fact or as a matter of law, that this redemption occurred at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend. The Commissioner did not file a cross appeal and so did not place the decision of the Board in this respect in issue before the Circuit Court.

There is certainly no presumption that a redemption of a Stock Dividend is equivalent to a taxable dividend. (*Commissioner* v. *Brown*, 69 Fed. (2) 602; *Commissioner* v. *Rockwood*, 82 Fed. (2) 359; *August Horrmann, supra.*)

The Government did not ask the Circuit Court to remand this case to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g) to the circumstances of this case. No authority is cited by the Government in its brief before this Court that this case may now be so remanded. The effect of so remanding this case would be to bring up again a question which was decided by the Board from which decision no cross appeal was taken. What the Government asked of the Circuit Court on the argument before that Court was to hold, as

a matter of law, that the redemption was essentially equivalent to the distribution of a taxable dividend (Govt. Brief before the C. C. A. p. 24). This the Circuit Court of Appeals refused to do.

It should, further, be stated that this issue does not involve an important question of Federal law nor a question which would be helpful in the decision of other cases, because the application of Section 115 (g) is dependent entirely upon the facts of each individual case.

Conclusion.

There is no important question of law here presented which needs further settlement by this court.

Respectfully submitted,

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Dated: April 30, 1937.

APPENDIX.

Revenue Act of 1928:

Section 115. DISTRIBUTIONS BY CORPORATIONS.

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

Revenue Act of 1936:

Section 115 (f) (1). GENERAL RULE.

A distribution made by a corporation to its stockholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

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IN THE

Supreme Court of the United States

October Term, 1937

No. 29

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

ANNIE M. PFEIFFER,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

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IN THE

Supreme Court of the United States

October Term, 1937

No. 29

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

ANNIE M. PFEIFFER,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 35) is a memorandum opinion not officially reported. The opinions of the Circuit Court of Appeals (R. 43) are reported in 88 Fed. (2d) 3.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered February 23, 1937 (R. 48). Petition on Certiorari was filed April 15, 1937 and was granted May 17, 1937 (R. 49). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

I. Is a dividend by a corporation in its own new and unissued Preferred Stock paid to holders of Common Stock, when there were other shares of Preferred Stock of the same classification outstanding a part of which were held by others than the common stockholders, subject to tax under Section 115 (f) of the Revenue Act of 1928?

II. Is such a Preferred Stock Dividend Income under the Sixteenth Amendment to the Constitution?

III. Should the Circuit Court of Appeals have passed upon—(1) the contention of the Commissioner that the shares of stock redeemed in 1931 had a zero basis; or (2) the alternative contention of the Commissioner that the amount received in redemption of such shares was taxable as a dividend under Section 115 (g) of the Revenue Act of 1928?

IV. If the question of the basis of the Dividend Stock is properly before this Court, what is the correct basis, assuming that such dividend was not subject to tax under the Statute at the time of its receipt;—is it *market value* or is it *zero*?

Statutes Involved.

The important Statutes involved, if not quoted in the text, are contained in the Appendix.

Statement of the Case.

This controversy arises out of a proposed deficiency in Federal Income Tax of the Responding Taxpayer for the year 1931.

Facts. William R. Warner Corporation, hereinafter called the "Corporation", was organized in 1920 under the Laws of Delaware, its stock at all times consisting of Common and non-voting Preferred. Each class of stock had a par value of $100 per share (R. 10). Dividends upon the Preferred Stock were never in default (R. 16). The authorized Capital Stock of the Corporation was increased several times by capitalizing its earnings (R. 11, 12, 13, 14).

In 1928 the Corporation issued and distributed 50,000 shares of the Preferred Stock, so authorized, as a dividend to the Common Stockholders of the Corporation in the ratio of one share of Preferred Stock to each two shares of Common Stock (R. 14).

In 1931 the Corporation issued and distributed 25,000 shares of Preferred Stock of the Corporation to the Common Stockholders as a dividend (R. 15), at a time when other Preferred Stock was outstanding, of which some was owned by the Common Stockholders (R. 15). The Taxpayer received, as her share of the 1931 distribution, 6,291¼ shares of Preferred Stock (R. 15). The market value of the shares so received was $629,125—their par value (R. 16).

Throughout these several recapitalizations, including the recapitalizations of 1928 and 1931, the terms, provisions and priorities of the two classes of Stock remained unchanged (R. 13). The earnings of the Corporation and its subsidiaries were far more than sufficient to pay the dividends on the Preferred Stock of the Corporation at any time outstanding (R. 16). Cash dividends were paid by the Corporation, as called for by its Preferred Stock, and large additional cash dividends were paid on the Common Stock during each of the years 1920 to 1931, inclusive (R. 16). The earned surplus of the Corporation and its subsid-

iaries on December 31, 1931, after the payment of the Stock Dividend in dispute, was $8,845,000 (R. 30).

In 1931 the Corporation redeemed with cash at par 8,500 shares of its Preferred Stock, including 2,000 shares belonging to the Taxpayer, which were a part of the Stock Dividend which she had received in 1928 (R. 16).

In her 1931 Income Tax Return the Taxpayer did not report as Income the 6,291¼ shares of Preferred Stock received by her as a Stock Dividend.

In her 1931 Income Tax Return the Taxpayer reported a capital gain of $180,100 as having resulted from the redemption of the 2,000 shares of Preferred Stock—a part of the shares issued to her in 1928 as a Stock Dividend—the gain having been determined in accordance with Regulations of the Treasury Department then effective, and paid a tax of $22,512.50 on such capital gain (R. 17).

History of the Case. The Commissioner, in determining the deficiency, included as taxable Income the sum of $629,125, representing the value of this Stock Dividend (R. 7). In addition, the Commissioner eliminated the capital gain of $180,100 and included as taxable income the sum of $200,000 received by the Taxpayer from such redemption (R. 7) as a taxable dividend under the provisions of Section 115 (g) of the Statute.

The Board of Tax Appeals held that the dividend paid in Preferred Stock in 1931 was not a "stock dividend" within the meaning of Section 115 (f) of the Revenue Act of 1928, and that such dividend was a taxable dividend. With respect to the 2,000 shares of stock issued in 1928 and redeemed in 1931, the Board held that, since in its opinion the Stock Dividend was subject to tax as Income when received in 1928, the redemption in 1931 was not essentially equiva-

lent to the distribution of a taxable dividend within the meaning of Section 115 (g).

On appeal by the Taxpayer to the Circuit Court of Appeals the Government contended that the Stock Dividend in question was not a "stock dividend" within the meaning of Section 115 (f) of the Statute and, therefore, was subject to Income Tax. This was the only issue raised on the appeal, the Government not having filed a cross appeal from the Board's decision on the application of Section 115 (g). Although no cross appeal was filed, the Government, in case stock dividends were held to be not subject to tax under the Statute, made the two following *alternative* contentions in its brief and oral argument before the Circuit Court of Appeals:

(1) That the Taxpayer realized a capital gain of $200,000 as a result of the redemption in 1931 of the 2,000 shares of Prefered Stock which she had received as a Stock Dividend in 1928, basing this contention upon the proposition that this Stock Dividend had a basis of zero.

This would result in a capital gain of $200,000 instead of $180,100, the amount originally reported by the Taxpayer in her Return. This contention was not made by the Commissioner in his Ninety-Day Letter nor in his Answer before the Board and was not urged before the Board nor raised by cross appeal to the Circuit Court of Appeals.

(2) In the event that the Court should hold that the basis of the redeemed Stock Dividend was not zero, the Government contends that the redemption in 1931 of a portion of the Preferred Stock dividend paid in 1928 was taxable as the essential equivalent to the distribution of a taxable dividend under Section 115 (g).

This alternative contention, if allowed, would result in adding $200,000 to the Taxpayer's income for 1931 in the

form of dividend Income. This contention was not raised by cross appeal.

The Government makes the same two alternative contentions in this Court.

Decision of Circuit Court of Appeals. The Circuit Court of Appeals held that the Preferred Stock Dividend received in 1931 was not subject to tax under Section 115 (f) of the Revenue Act of 1928.

The Court refused to sustain a deficiency *pro tanto* upon the theory that the cost basis of the stock sold to the Corporation during the taxable year, and previously received as a Stock Dividend in 1928, was zero, because this point was not raised before nor decided by the Board.

The Court also refused to consider whether the redemption of the Preferred Stock in 1931 was the equivalent of the distribution of a taxable dividend under Section 115 (g), because the Government did not file a cross appeal from the decision of the Board, and further because the Board did not find that the redemption of the Preferred Stock occurred at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend under the provisions of Section 115 (g).

Preliminary Statement.

If this Court holds that the 1931 Preferred Stock dividend paid on Common Stock was exempt from taxation under the Statute (Section 115 (f) of the Revenue Act of 1928), it is immaterial, so far as the *taxability of such dividend* is concerned, whether it constituted "Income" under the Sixteenth Amendment to the Constitution. But it will be necessary on the question of *basis*, if for no other reason, to determine whether such stock dividend constituted In-

come under the Sixteenth Amendment, provided this Court holds that the question of the basis of the 1928 Preferred Stock dividend, a part of which was redeemed in 1931, was properly raised by the Commissioner on appeal.

The question, therefore, as to whether the stock dividends of 1928 and 1931, both of which were of the same character, constituted "Income" which Congress could have taxed under the Sixteenth Amendment to the Constitution will be discussed under Point II, following the discussion of the Statutory exemption.

Summary of Argument.

Point I.

All stock dividends—those that do and those that do not constitute Income—are specifically exempted from taxation under Section 115 (f) of the Revenue Act of 1928, which provided that "A stock dividend shall not be subject to tax".

The term "stock dividend" has been uniformly defined, both by courts and text-writers, as including *any dividend paid by a corporation in its own new or unissued stock.*

In the *Koshland* decision, in the Revenue Act of 1936 and in the Treasury Regulations appertaining thereto, the term "stock dividend" is applied to dividends which do, as well as those which do not, constitute Income.

The decision of this Court in the *Koshland* case recognized that all stock dividends were exempted from tax by Statute.

A consideration of the history of the legislation exempting stock dividends from tax discloses that the Treasury Department gave a broader interpretation to the decision of this Court in the *Macomber* case than was required by that decision, as now interpreted. The Regulations and

rulings of the Treasury Department, issued shortly after the *Macomber* decision, which continued uninterruptedly and were relied upon by taxpayers for over fourteen years, specifically provided that all stock dividends were immune from tax, whether constituting a distribution of common stock on common stock or a distribution of stock of a different quality or preference from that on which the dividend was paid.

Congress, relying upon and adopting the foregoing interpretation of the Treasury Department, exempted all stock dividends from taxation in the Revenue Act of 1921 and, with the knowledge that the Treasury Department was applying this exemption to all types of stock dividends, re-enacted such exemption in identical language in the succeeding five Revenue Acts. The re-enactment by Congress, without change, of a statute which had previously received long continued administrative construction, is an adoption by Congress of such construction.

Point II.

Under the *Koshland* decision, a stock dividend constitutes Income if, as a result of the receipt of such dividend the stockholder's proportional interest is *essentially* different from his former interest. The interests of Respondent and the other stockholders of the Warner Corporation, after they received their Preferred Stock dividends, were substantially the same as before they had received such dividends—the dividends giving them nothing which added anything of value to what they had before or which could be measured in terms of Income. To the exact extent that the stockholders of the Warner Corporation received value

in the form of Preferred Stock, they suffered a diminution in value in their Common Stock. Hence, they should not be regarded as having received Income by virtue of the Preferred Stock distributed as a dividend.

Point III.

The question of the taxability as a capital gain of the amount received upon the redemption in 1931 of stock issued as a dividend in 1928 was not an issue before, nor decided by, the Board of Tax Appeals. The Circuit Court of Appeals was, therefore, without authority to decide this question.

The question of the taxability, under Section 115 (g) of the Revenue Act of 1928, of the amount received upon the redemption in 1931 of the stock issued as a dividend in 1928 was decided by the Board adversely to the Government. No cross appeal having been taken by the Government, this question was not an issue before the Circuit Court.

Point IV.

Assuming that the Preferred Stock received by Respondent in 1928 constituted Income, its basis for the purpose of determining gain or loss upon its subsequent redemption is its fair market value at date of receipt. This principle is well established by the decisions of this and other courts, which hold that, where property does not have a "cost" in the conventional sense and the applicable Revenue Act does not prescribe otherwise, the basis of such property, for the purpose of determining gain or loss upon subsequent disposition, is its fair market value when acquired.

ARGUMENT.

POINT I.

All stock dividends—those that do and those that do not constitute Income—are exempt from taxation under Section 115 (f) of the Revenue Act of 1928.

The Koshland Case.

The question as to whether Congress, in Section 115 (f) of the Revenue Act, exempted from taxation *all* stock dividends—those which do and those which do not constitute Income to the shareholder—was squarely presented to this Court in the case of *Koshland* v. *Helvering,* 298 U. S. 441 (May 18, 1936). On this point this Court said at page 443:

> "The petitioner contends, first, that the dividends she received were not stock dividends exempted from taxation by the revenue acts; * * *. The respondent answers that the distributions were stock dividends because made in the capital stock of the corporation and come within the plain meaning of the provisions exempting stock dividends from income tax; * * *."

Indeed, practically the entire argument made by the Government in its brief in this Court in the *Koshland* case was in support of the proposition that:

> "The unambiguous language of the provision 'a stock dividend shall not be subject to tax' warrants the conclusion that Congress intended to exempt all stock dividends from tax * * *."

(Government's brief in the *Koshland* case, page 17.)

In its opinion in the *Koshland* case this Court said, at page 445:

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, *the Treasury gave the decision a broader interpretation which*

> *Congress followed in the Act of 1921.* Soon after the passage of that Act, this court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially different from his former interest. *Nevertheless the successive statutes and Treasury regulations respecting taxation of stock dividends* remained unaltered." (Emphasis supplied.)

The above language has been generally accepted as indicating the opinion of this Court that Congress, in the Revenue Act of 1921 and subsequent Revenue Acts, exempted all stock dividends from tax.

This was clearly the view of Mr. Justice STONE and Mr. Justice CARDOZO who, in their dissenting opinion, said:

> "The meaning of the Act of Congress exempting stock dividends from taxation as income at the time of distribution has had a practical construction through administrative action and legislative acquiescence. Even though the meaning may have been uncertain in the beginning, it has now become fixed in accordance with long continued practice. • • • *This is not denied in the opinion of the court.*" (Emphasis supplied.)

The Board of Tax Appeals appears to have placed the same interpretation upon the *Koshland* decision. In the case of *Horrmann* v. *Commissioner*, 34 B. T. A. 1178 (October 21, 1936), the Board said:

> "But whether we are right or wrong in our interpretation of the Koshland case and whether or not the preferred stock dividend of 1922 was income, we

are of the opinion that it was not taxable to the stockholders. Of course, if it was a stock dividend within the compass of *Eisner* v. *Macomber*, it was not income under the Sixteenth Amendment; *if it was income as in the Koshland case, it was nevertheless a stock dividend which was specifically exempt from tax under section 201 (d) of the Revenue Act of 1921.*

"This exemption has been of long standing as pointed out in the opinion in the *Koshland* case. All of the revenue acts from 1921 to 1934, inclusive, have specifically provided for the exemption and the Treasury regulations over an equally long period of time have broadly held stock dividends nontaxable." (Emphasis supplied.)

The above statement would seem clearly to indicate that the Board of Tax Appeals concedes that its decisions in the case at bar and in the *Gowran* case and in all its prior decisions, including *Tillotson Manufacturing Company* v. *Commissioner*, 27 B. T. A. 913, on the question of the taxability of stock dividends under the Statute were erroneous, and is now of the opinion that all stock dividends are exempt from tax under the Statute.

The opinion of the Circuit Court of Appeals for the Second Circuit in the case at bar indicates that such Court interprets the opinion in the *Koshland* case as holding that all stock dividends are exempt from tax under the Statute.

It should be noted that the same Commissioner and the same Solicitor General, in the short space of one year, have changed their position as to the scope and meaning of Section 115 (f) in spite of the fact that the position taken by the Government in the *Koshland* case was based upon fifteen years of consistent administrative construction. The function of the Commissioner is to administer the Revenue Statutes consistently. Certainly the *Koshland* case does not require the Commissioner to change his position.

It is true that this Court said in the *Koshland* case that it was immaterial for the purposes of that case whether

Congress had taxed the dividends at the time of receipt. But the question of the taxability of the dividends under Section 115 (f) was present in the case, was argued by counsel, and was deliberately considered by the Court. It follows, therefore, that the implication in the language of the opinion that such dividends were exempted by the Statute from taxation, "if *dictum* * * * should * * * be regarded as *'judicial dictum'*, in contradistinction to mere *obiter dictum.*"

> *Buchner* v. *Chicago, N. & N. W. Railway Company,* 60 Wisc. 264, 268.

As stated in *Florida Central Railroad Company* v. *Schutte,* 103 U. S. 118, 143:

> "It cannot be said that a case is not authority on one point because, although that point was properly presented and decided in the regular course of the consideration of the cause, something else was found in the end which disposed of the whole matter."

The question presented for determination in the case at bar is, therefore, not merely whether the decision of the Circuit Court of Appeals—holding that *all* stock dividends were exempt from taxation under the Revenue Act of 1928—should be reversed, but also whether the plain implication of the opinion of this Court in the *Koshland* case should be overruled.

The Term "Stock Dividend" is Free from Ambiguity and Embraces all Dividends Paid by a Corporation in its own New or Unissued stock.

This Court has frequently stated that the language of an Income Tax Statute must be given its natural and ordinary meaning.

> *Lang* v. *Commissioner,* 289 U. S. 109;
> *Reinecke* v. *Smith,* 289 U. S. 172.

When the words in the Statute are clear and unambiguous, they are not open to speculative construction:

> "It is elementary that where no ambiguity exists there is no room for construction."
>
> *United States* v. *Missouri Pacific Railroad Company,* 278 U. S. 269, 277.

Applying this principle of construction to Section 115 (f) of the Revenue Act of 1928, it becomes immediately apparent that Congress, in providing that "a stock dividend shall not be subject to tax," intended to exempt from taxation all dividends comprehended within the term "stock dividend".

In 14 C. J. 812, the term "stock dividend" is defined as follows:

> "A dividend made payable by a corporation in new or unissued shares of its own stock is a stock dividend. (Citing cases)."

A similar definition is contained in Thompson on Corporations, Vol. 7, 3d Ed. (1927), page 137, where the term is defined as follows:

> "A stock dividend is what the term itself implies, a distribution of the stock of the corporation among the stockholders as a dividend."

Clark & Marshall, Private Corporations, Vol. 2, Section 523 e, page 1601:

> "A stock dividend is a dividend payable in reserved or additional stock of the corporation, instead of in cash or property."

Gray v. *Hemenway,* 212 Mass. 239, 98 N. E. 789:

> "Moreover by a stock dividend is generally understood a distribution made by a corporation of shares of its own stock."

As far as we have been able to ascertain, there is no authority, judicial or otherwise, in the entire field of corporation law for limiting the meaning of the term "stock dividend" to a distribution of common stock on common stock or to a distribution of stock of the same quality or preference as that on which the dividend was paid. *The Government does not contend otherwise.*

It was held in the *Koshland* case that some types of dividends paid by a corporation in its own stock constitute Income to the shareholder but other types do not; that a dividend in stock which effects no change in the proportional interest of the stockholder does not constitute Income within the intendment of the Sixteenth Amendment, while a dividend which *essentially* alters the stockholder's proportional interest is not constitutionally immune from taxation as Income.

This Court recognized, however, that both types of dividends—those which *do* and those which *do not* constitute Income—come within the definition of the term "stock dividend". Thus it is stated in the *Koshland* opinion, page 445:

> "Soon after the passage of that Act, this court pointed out the distinction between a *stock dividend* which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and *such a dividend* where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was *essentially* different from his former interest." (Emphasis supplied.)

Even now, after the decision in the *Koshland* case, and after Congress in the Revenue Act of 1936 (Section 115 (f)) limited the exemption to such stock dividends as are constitutionally tax-free stock dividends, the Treasury recog-

nizes that both classes of dividends are properly designated "stock dividends".

In Article 115-7 of Regulations 94, relating to the Revenue Act of 1936, the following language is used:

> "The Supreme Court has pointed out some of the characteristics distinguishing a *stock dividend* which constitutes income from one which does not constitute income within the meaning of the Constitution. * * * A *stock dividend* constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A *stock dividend* does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old." (Emphasis supplied.)

Congress itself used the term "stock dividend" to describe both classes of dividends in Section 115 (f) of the Revenue Act of 1936 which reads as follows:

> "Stock Dividends.
>
> "(1) General Rule.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

It is wholly immaterial whether the shares of stock received by the Taxpayer as a dividend did or did not constitute Income to her. Under the accepted definition, the dividend received by the Taxpayer was a "stock dividend" and was exempt from taxation by virtue of express language of Section 115 (f) of the Revenue Act of 1928 which provides that "a stock dividend shall not be subject to tax".

A consideration of Section 115 (f) of the Revenue Act of 1928, in the light of its Legislative, Administrative and Judicial History, compels the conclusion that Congress intended to exempt all stock dividends from tax.

As pointed out in the preceding Subdivision of this Point, the meaning of the term "stock dividend", as used in Section 115 (f) of the Revenue Act of 1928, is wholly free from ambiguity. A "stock dividend" is any dividend paid by a corporation in its own new or unissued stock. This being so, it is idle for the Government to argue that when Congress declared that "A stock dividend shall not be subject to tax", it was not thereby exempting a dividend paid by a corporation in its own unissued preferred stock ratably to the holders of its common stock.

Even if we assume, however, that the term "stock dividend" as used in the Statute is ambiguous, thereby opening the way to an independent consideration of the legislative intent, the circumstances under which the Statute was originally enacted and its subsequent reenactment after its administrative construction clearly establish that Congress intended to exempt all stock dividends from taxation.

The Congress in earlier Revenue Acts had already given a meaning to the term "stock dividend". Section 2 (a) of the Revenue Act of 1916, in so far as is here material, provided as follows:

> "That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash, or *in stock of the corporation,* * * * which *stock dividend* shall be considered income, to the amount of its cash value." (Emphasis supplied.)

A similar provision was contained in the Revenue Act of 1917 (Section 31 (a)), and in the Revenue Act of 1918 (Section 201 (a) and (c)).

In *Eisner* v. *Macomber,* 252 U. S. 189, decided March 8, 1920, this Court determined that the stock dividend there involved was not Income within the meaning of the Sixteenth Amendment and that the Revenue Act of 1916 was invalid, in so far as it imposed a tax upon the stockholders because of the receipt of such a dividend.

The dividend involved in the *Macomber* case was paid in Common stock on Common stock, and the question whether stock dividends, other than Common on Common, were constitutionally immune from taxation was not presented. However, in addition to stating that the dividend in question did not "alter the pre-existing proportionate interest of any stockholder", this Court said at page 211:

> "A 'stock dividend' shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.
>
> "*The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit;* on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance, and not to

> form, he has received nothing that answers the definition of income within the meaning of the 16th Amendment." (Emphasis supplied.)

As indicated in the opinion of this Court in the *Koshland* case, at pages 444 and 445, the true import of the *Macomber* decision, as now interpreted, was not for some time recognized. This Court had held in the *Macomber* case not only that the stock dividend there involved effected no change in the stockholder's pre-existing proportionate interest, but also that the "controlling fact" was that the stockholder "received nothing out of the company's assets for his separate use and benefit". If the latter point were in fact the *ratio decidendi* of the *Macomber* case, all stock dividends would have been constitutionally immune from taxation, because in no case where a stockholder receives a dividend paid by a corporation in its own new or unissued stock does the stockholder receive anything "out of the company's assets for his separate use and benefit".

The Treasury Department considered the "severance" test controlling. Accordingly, shortly after the decision in the *Macomber* case, it promulgated Treasury Decision 3052, 3 C. B. 38 (August 4, 1920), expressly and unqualifiedly assuring taxpayers that all stock dividends were free from taxation:

> "The following applications of the decision of the Supreme Court of the United States in the case of *Eisner* v. *Macomber* in the determination of the taxability of dividends declared by corporations are published for the information and guidance of internal revenue officers *and others concerned:*
>
> "1. Where a corporation, being authorized so to do by the laws of the State in which it is incorporated, transfers a portion of its surplus to capital account, issues new stock representing the amount of the surplus so transferred, and distributes the stock so

> issued to its stockholders, such stock is not income to the stockholders, *and the stockholders incur no liability for income tax by reason of its receipt.*" (Emphasis supplied.)

Shortly afterwards, the Treasury Department issued Treasury Decision 3059, 3 C. B. 38 (August 16, 1920), revoking Article 1545 and amending Article 1547 of Regulations 45 issued earlier in 1920 under the Revenue Act of 1918 to provide that "stock received as a dividend does not constitute taxable income to the stockholder." This Treasury Decision prescribed a method for allocating the cost of the original shares between such shares and the dividend shares for the purpose of determining gain or loss upon the disposition of either, not only where the new stock was of the same character as the old, but also where the new was of a different character or preference. This Decision provided in part:

> "2. *Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid,* the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock shall be divided between such old stock and the new stock, or classes of new stock, in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost of each share of stock will be the quotient of the cost of the class to which such share belongs divided by the number of shares in that class." (Emphasis supplied.)

Following the issuance of Treasury Decision 3059, *supra*, the Treasury Department issued O. D. 732, 3 C. B. 39 (1920), *giving more specific instructions as to the method of adjusting the cost of both classes of stock where preferred stock is issued as a dividend on common stock.*

Still later, O. D. 801, 4 C. B. 24 (January-June, 1921), stated as follows:

> *"A stock dividend paid in true preferred stock is exempt from tax the same as though the dividend were paid in common stock;* • • • " (Emphasis supplied.)

Thus it is clear that the Treasury Department interpreted the *Macomber* decision as holding that all stock dividends were constitutionally immune from taxation. This Court, in the *Koshland* case, at page 444, recognized this administrative construction, stating:

> "After the decision the Treasury revoked regulations to the effect that a dividend paid in the corporation's stock is income and issued amended regulations, broadly phrased, *to exempt all income in the form of stock dividends, whether the dividend shares be of the same class as those theretofore held by the stockholder or of a different class,* and prescribing the method of allocating the original cost as between the old and the new stock for purposes of calculating gain or loss upon realization." (Emphasis supplied.)

Subsequent to the promulgation of the Treasury Decisions and Office Decisions quoted above, the Revenue Act of 1921 was enacted and Congress, in Section 201 (d) of that Act, provided:

> "A stock dividend shall not be subject to tax • • •."

Congress, in the Revenue Act of 1921, not only expressly exempted all stock dividends from taxation, but also amended the definition of the term "dividend" as contained in the Revenue Acts of 1916, 1917 and 1918, and defined the term "dividend" as "any distribution made by a corporation to its shareholders, or members, whether in cash or in other property, out of its earnings or profits accumulated

since February 28, 1913". (Section 201 [a].) This explicitly eliminated from the definition of the term "dividend" a distribution made by a corporation in its own stock. (See page 17 of this Brief.)

The sequence of events was that the *Macomber* decision was handed down on March 8, 1920; the Treasury Department rendered its so-called "severance test" Decisions in August, 1920; the Revenue Act of 1921 was passed on November 23, 1921.

As indicated by House Reports No. 350, Sixty-seventh Congress, 1st session, page 8, and Senate Reports No. 275, Sixty-seventh Congress, 1st session, page 9, the *Macomber* decision was the underlying reason for the adoption of Section 201 (d) of the Revenue Act of 1921. (This is also shown by the Debates in Congress.)

On October 19, 1921, Senator McCumber, as reported in Volume 61, Congressional Record, page 6474, in answering Senator Nelson's criticism that the proposed bill did not tax stock dividends, said:

> "If the Senator will read the Supreme Court decision carefully, he will find that the reason given for holding that you could not levy a tax upon the undistributed profits of a corporation, even though they were in the form of dividend certificates, *was that the taxpayer was not in possession and control of the funds, and he could not be taxed upon funds which were not his, and over which he had no control.* That was the basis of the decision, and that being the basis of the decision, you could not by any character of language tax those funds while they were still in the hands of the corporation. You could not tax them as against the holder of the certificates. That, I think, was the reason which actuated every member of the committee, so far as I know." (Emphasis supplied.)

It thus appears obvious that Congress followed the interpretation of the *Macomber* decision that had been placed

upon it by the Treasury Department, and intended to and did exempt from taxation *all stock dividends.* Such a conclusion is borne out by the opinion of this Court in the *Koshland* case, at page 445:

> "Although Eisner v. Macomber affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, *the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921.*" (Emphasis supplied.)

The Treasury Department was not alone in construing the *Macomber* decision as establishing the "severance" test as the controlling test. Leading Constitutional authorities likewise generally understood that the severance test was the controlling test established by the *Macomber* case in determining whether a stock dividend was constitutionally immune from taxation.

> *Stock Dividends, Direct Taxes and the Sixteenth Amendment,* by Thomas Reed Powell, Columbia Law Review, Vol. 20, p. 536 (1920);
> *Corporate Personality in Income Taxation,* by Arthur A. Ballantine, Harvard Law Review, Vol. 34, p. 573 (April, 1921);
> *Stockholders and the Federal Income Tax,* by Joseph H. Beale, Harvard Law Review, Vol. 37, p. 1 (November, 1923).

The comments on the *Macomber* decision in the opinions of the Judges of the House of Lords in the case of *Commissioners of Inland Revenue* v. *Blott,* 8 Tax Cases, 101 (1921), also indicate that the House of Lords considered "severance" to have been the test applied in the *Macomber* case. In these opinions a part of the opinion of Mr. Justice PITNEY in the *Macomber* case was quoted.

The intention of Congress is to be gathered from the words of the Act interpreted according to their ordinary acceptation, and, when it becomes necessary to do so, in the light of the circumstances as they existed when the Statute was passed.

Platt v. *The Union Pacific Railroad Company*, 99 U. S. 48 (1879);
Louisville & Nashville Railroad Company v. *Mottley*, 219 U. S. 467 (1911).

If, therefore, it be thought necessary to resort to the circumstances existing at the time of the enactment of the Statute, what could be more cogent evidence of the general understanding of the *Macomber* decision than the interpretation given to such decision by the Treasury Department and the Committees of Congress and by such distinguished Constitutional authorities. All these concurred in interpreting the *Macomber* decision as resting upon the basis that a stock dividend is not Income to the recipient stockholder because "the stockholder has received nothing out of the company's assets for his separate use and benefit". *Eisner* v. *Macomber, supra.*

After the enactment of the Revenue Act of 1921, the Treasury Department in 1922 issued Regulations 62, interpretative of that Act. Article 1548 of such Regulations provides, in part, as follows:

> "*Stock issued by a corporation as a dividend does not constitute taxable income to a stockholder of such corporation,* but gain may be derived or loss sustained by the stockholder from the sale of such stock." (Emphasis supplied.)

Congress re-enacted the identical provision of the Revenue Act of 1921—"A stock dividend shall not be subject to tax"—as Section 201 (f) of the Revenue Acts of 1924 and

1926 and Section 115 (f) of the Revenue Acts of 1928, 1932, and 1934.

The Treasury Regulations interpretative of the subsequent Revenue Acts, including Article 628 of Regulations 74 promulgated under the Revenue Act of 1928 which is directly applicable to the instant case, contain substantially the same unequivocal grant of exemption, as is declared in Article 1548 of Regulations 62, above quoted.

> Article 1548 of Regulations 62, under the 1921 Revenue Act; Article 1548, Regulations 65, 1924 Act; Article 1548, Regulations 69, 1926 Act; Article 628, Regulations 74, 1928 Act; Article 628, Regulations 77, 1932 Act, and Article 115-8, Regulations 86, 1934 Act.

Subsequent Treasury Decisions and rulings are uniformly to the same effect:

> Office Decision 732, 3 C. B. 39 (1920); O. D. 735, 3 C. B. 40 (1920); O. D. 859, 4 C. B. 24 (1921); O. D. 801, 4 C. B. 24 (1921); Solicitor's Opinion, 144, C. B. 1-2, 4 (1922); A. R. R. 1127, C. B. 1-2, 8 (1921); I. T. 1930, C. B. III-1, 39 (1924) T. D. 3553 and T. D. 3554, C. B. III-1, 38 (1924); I. T. 1900, C. B. III-1, 82 (1924); G. C. M. 916, C. B. VI-1, 135 (1927); I. T. 2449, C. B. VIII-1, 101 (1929); G. C. M. 6709, C. B. VIII-2, 132 (1929); I. T. 2538, C. B. IX-1, 144 (1930).

Four years after the decision in the *Macomber* case the opinion in that case was reviewed and analyzed by this Court in *Weiss* v. *Stearn* (decided May 26, 1924), 265 U. S. 242, the Court stating at page 253:

> "*Eisner* v. *Macomber*, 252 U. S. 189, * * * gave great consideration to the nature of income and stock dividends. It pointed out that, within the meaning of the 16th Amendment, income from capital is gain severed therefrom and received by the taxpayer for his separate use; that the interest of the stockholder

> is a capital one and stock certificates but evidence of it; that, *for purposes of taxation, where a stock dividend is declared, the essential and controlling fact is that the recipient receives nothing of the company's assets for his separate use and benefit.*" (Emphasis supplied.)

The question involved in the case of *Weiss* v. *Stearn* was whether Income was derived from the exchange of shares of stock in one corporation for shares of the same character in a second corporation organized to take over its assets and business. The Court applying the general principles of the *Macomber* case held that no Income was derived from the transaction.

A year after the case of *Weiss* v. *Stearn* was decided, this Court rendered its decision in *Marr* v. *United States,* (decided June 1, 1925) 268 U. S. 536. The same general question was involved as in the case of *Weiss* v. *Stearn.* One distinction was that in the *Weiss* case the new shares possessed the same essential characteristics as the old, whereas in the *Marr* case the characteristics of the old and new shares were essentially different. Accordingly, the shareholder was held to have realized Income upon the exchange, the Court stating at pages 541; 542:

> "The case at bar is not one in which, after the distribution, the stockholders have the same proportional interest of the same kind in essentially the same corporation."

It is important to note that in the *Marr* case four of the Justices dissented upon the ground that *Weiss* v. *Stearn* turned "upon the approved definition of income from capital as something severed therefrom and received by the taxpayer for his separate use and benefit".

The case of *Marr* v. *United States* involved a distribution in reorganization, not a stock dividend, and the Treasury Department, even after this decision, still adhered to

the "severance" test in determining whether a corporate distribution constituted Income. Thus in 1929 the General Counsel for the Bureau of Internal Revenue ruled that, under Section 115 (f) of the Revenue Act of 1928, a stock dividend paid by a corporation in a class of stock different from that upon which the dividend was paid, did not constitute Income. G. C. M. 6709, VIII-2 C. B. 132. In support of his ruling the General Counsel stated:

> "The stockholder receives nothing out of the corporation's assets for his individual use, and those assets still remain the property of the corporation, subject to all the hazards of the business. He does not receive 'income'; the corporation is none the poorer, and the stockholder is none the richer. There is merely a transfer of surplus to capital account, although the number of shares issued and outstanding is increased. Such dividends would not, under *Eisner* v. *Macomber,* supra, be taxable."

It was not until March 14, 1935, when the Circuit Court of Appeals for the Sixth Circuit, rendered its opinion in *Tillotson Manufacturing Company* v. *Commissioner,* 76 Fed. (2d) 189, that the *Weiss* and *Marr* decisions were applied by the courts to stock dividends and the ruling announced that a stock dividend which results in a substantial alteration in a stockholder's pre-existing proportionate interest constitutes Income.

It is therefore readily understandable why, until after the decisions of the Circuit Court in the *Tillotson* case and of this Court in the *Koshland* case, no change was made in the provisions of the successive Revenue Acts nor in the Treasury Regulations unqualifiedly granting exemption to all stock dividends.

The Government now argues (in direct contradiction to its argument before this Court in the *Koshland* case) that Congress was exempting stock dividends only because it

believed that it was required to do so by the *Macomber* case, and that consequently it was not exempting such stock dividends as constituted Income.

But, as already illustrated, the true import of the *Macomber* decision, as now interpreted, was not realized in 1921. Admittedly, the Treasury Department, when in 1920 it amended Article 1547 of Regulations 45, interpreted the *Macomber* decision as holding *that no stock dividend* can constitute Income and, as pointed out in the *Koshland* case, it was the interpretation that the Treasury Department gave to the decision in the *Macomber* case "which Congress followed in the Act of 1921".

The fallacy of the Government's argument lies in the fact that it attributes to Congress knowledge in 1921 of a principle of law that was not suggested until the *Marr* decision in 1925 and not definitely established by this Court until the *Koshland* decision in 1936—viz., that certain types of stock dividends do constitute Income.

The foregoing consideration of the legislative, administrative and judicial history of the successive Revenue Acts conclusively demonstrates, it is submitted, that Congress, at the time of the enactment of the Revenue Act of 1921, intended to exempt *all stock dividends.* The Treasury Department, Congress, and others concerned believed that under the *Macomber* decision all stock dividends were immune from taxation.

As already pointed out, the Treasury Department in the Regulations and Rulings promulgated under the Revenue Act of 1921 and successive Revenue Acts uniformly interpreted the "stock dividend" provision as exempting all stock dividends.

The rule is well established by decisions of this Court that a regulation of an administrative department, such as the Treasury Department, if not in violation of an express

statutory provision, possesses the same effectiveness and sanction as statutory law. In *Maryland Casualty Company* v. *United States,* 251 U. S. 342, 349, this Court said:

> "It is settled by many recent decisions of this court that a regulation by department of government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with express statutory provision."

Furthermore, the repeated re-enactment by Congress of the provision exempting stock dividends, without change or modification, is convincing evidence of the explicit sanction and approval by Congress of the administrative construction of the Statute.

In *National Lead Company* v. *United States,* 252 U. S. 140, 146, this Court declared this principle as follows:

> "During all the intervening twenty-four years this rule of the Department with respect to drawbacks had been widely applied to many articles of much greater importance than linseed or its derivatives, and the practice was continued, linseed included after 1894, until the petition in this case was filed. *The re-enacting of the drawback provision four times, without substantial change, while this method of determining what should be paid under it was being constantly employed, amounts to an implied legislative recognition and approval of the executive construction of the statute (United States* v. *Philbrick, supra; United States* v. *Falk,* 204 U. S. 143, 152, 51 L. ed. 411, 414, 27 Sup. Ct. Rep. 191; *United States* v. *Cerecedo Hermanos y Compania,* 209 U. S. 337, 52 L. ed. 821, 28 Sup. Ct. Rep. 532), for Congress is presumed to have legislated with knowledge of such an established usage of an executive department of the government (*United States* v. *Bailey,* 9 Pet. 238, 256, 9 L. ed. 113, 120)." (Emphasis supplied.)

In *United States* v. *Cerecedo Hermanos y Compania*, 209 U. S. 337, this Court unequivocally stated this rule:

> "And we have decided that the re-enactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction." (p. 339).

The Government does not deny that under its consistent administrative interpretation of Subdivision (f) *all stock dividends* were exempted from tax. Nor does the Government claim that the Regulations and rulings evidencing such interpretation contravened the Statute exempting stock dividends from tax. The Government attempts, however, to avoid the effect of the Regulations and rulings by contending that "the administrative interpretation of the meaning of 'stock dividends' in Subdivision (f) was at all times integrated with the apportionment of the cost basis of the original stock between the original stock and the stock received as a dividend thereon," and that since such apportionment was held to be invalid in the *Koshland* case "the interpretation of the stock dividend exemption • • • must also necessarily fail". (Government's Gowran brief, p. 23, to which this Respondent is referred.)

It is immaterial whether or not the two portions of the Regulation were "integrated". The portion of the Regulation wherein the Commissioner interpreted Subdivision (f) as exempting *all stock dividends* from tax *admittedly* represented the construction *actually* placed upon Subdivision (f) by the Commissioner. That Subdivision as thus construed by the Commissioner was re-enacted, without change, in Section 201 (f) of the Revenue Acts of 1924 and 1926 and Section 115 (f) of the Revenue Acts of 1928, 1932 and 1934. Under the well established principle consistently enunciated by this Court, such re-enactment by Congress,

without change, of subdivision (f) was "an adoption by Congress of such construction". *U. S.* v. *Cerecedo Hermanos y Compania, supra.*

Moreover, it is not accurate to argue, as the Government does (relying upon the dissenting opinion of Judge LEARNED HAND) that there has never been any administrative interpretation of Section 115 (f) which did not immediately connect it with the method of calculating "basis". There are many administrative interpretations of Section 115 (f) which make no reference to the question of basis. O. D. 801, 4 C. B. 24 (1921); O. D. 859, 4 C. B. 24 (1920); I. T. 2449, C. B. VIII-1, 101 (1929); G. C. M. 6709, C. B. VIII-2, 132 (1929); I. T. 2538, C. B. IX-1, 144 (1930).

Even however, if the rulings and Regulations be eliminated from consideration, the Government gains no comfort therefrom. For the fact still remains that Congress exempted all stock dividends from taxation at time of receipt—in language which is plain and which fully gave effect to the legislative intent.

The conclusion that Congress in the six successive Revenue Acts from 1921 to 1934 used the term "stock dividend" in its ordinarily accepted sense—as any dividend paid by a corporation in its own new or unissued stock—is further fortified by the change in the law made by the Revenue Act of 1936 (Section 115 (f)), which limited the exemption to stock dividends constitutionally exempt from taxation.

It is a familiar canon of statutory construction that:

> "The deliberate selection of language so differing from that used in the earlier acts indicates that a change of law was intended."
>
> *Brewster* v. *Gage,* 280 U. S. 327, 337.

The Report of the Ways and Means Committee of the House of Representatives, submitted to the House on April 21, 1936, which accompanied the "Revenue Bill of 1936",

known as H. R. 12395, establishes a legislative purpose to amend the Statute—not to clarify the existing law. The Report of the Ways and Means Committee, Report No. 2475, 74th Congress, 2nd Session, p. 10, states, in part, as follows:

> "It may be well to note the more important of certain miscellaneous *changes* recommended in existing law.
>
> * * * * * * *
>
> "It is provided in Section 115(f) that stock dividends shall be subject to tax to the extent that such dividends constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution." (Emphasis supplied.)

The remarks of Representative Vinson, who was in charge of the 1936 Revenue Bill in the House of Representatives, made on the floor of the House while Congress was considering the Revenue Bill of 1936, evidence a clear and certain legislative purpose to revoke the complete exemption previously granted by Congress and to substitute therefor a legislative exemption identical in extent with the constitutional exemption protecting stock dividends from taxation. These remarks further demonstrate that the sponsors of the Bill were cognizant of the fact that Congress, in the earlier Revenue Acts, had expressly exempted all stock dividends from taxation.

On April 27, 1936, Representative Vinson made the following statement, which is reported in the Congressional Record of that day at page 6214:

> "Coming now to stock dividends, this is a field that has more or less been surrounded with mystery. *Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill.* There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of *Eisner versus Macomber.*" (Emphasis supplied.)

The Government, in quoting from the Congressional Record giving the debate in the House on the stock dividend question, does not quote the statement made by Representative Vinson on April 27, 1936 above given. This quotation shows that Representative Vinson, who was in charge of the Bill, clearly understood that a change in the existing law was intended and that he so informed the House. Upon this preliminary statement of Representative Vinson all the following debate hangs.

On April 28, 1936, the following colloquy took place between Representative Vinson and Representative Treadway (Congressional Record of that day at p. 6309):

> "Mr. Treadway. May I ask the gentleman one question?
>
> "I think he has covered subdivision (j) very thoroughly. Now, referring to section (f), taxable stock dividends, which is, of course, entirely new, that is, the principle is entirely new in that there is a set-up there under which stock dividends can be taxed, which has not been in the previous law. I am correct in that?
>
> "Mr. Vinson of Kentucky. If the gentleman from Massachusetts will permit, under the 1934 act there was a provision that said no stock dividend should be taxed. In a very celebrated case, Eisner against Macomber, the Supreme Court held that the tax (sic) dividend involved in that case was not taxable. *Out of that case grew up the idea that no stock dividend was taxable. I think it was because of that notion that the language to which I have referred, as appears in the 1934 bill, found its way there; that is, that no stock dividend should be taxed.*
>
> "The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder.
>
> • • • • • • • • •

"Mr. Treadway. The language stricken out, I may say, reads as follows:

"(b) (sic) Stock dividends: A stock dividend shall not be subject to tax.

"That is the existing law and has been the law most of the time since the Eisner against Macomber decision. In the next tax bill after that decision that language was included.

"I understand the gentleman's explanation to be that the language of the act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision.

"Mr. Vinson of Kentucky. That is correct.

"Mr. Treadway. The language now substituted for the stricken language describes new stock dividends that can be taxed or what portion of stock dividends under the sixteenth amendment can in the future be taxed. Is that the right conception of the intention?

"Mr. Vinson of Kentucky. Well, we take the broad position that stock dividends that are taxable income within the sixteenth amendment are subject to taxation, and if they are not such stock dividends and not any taxable income under the sixteenth amendment, they are not subject to taxes." (Emphasis supplied.)

The Government has quoted a portion of the foregoing colloquy between Representatives Vinson and Treadway and attempts to draw therefrom the conclusion that the change of language in Section 115(f) in the 1936 Act amounted merely to a clarification of existing law rather than a change in law. Apparently this conclusion is predicated upon the isolated words of Mr. Vinson constituting only a small portion of a single sentence. The full sentence with the italicized language corresponding to the italicized portion of the Government's brief reads as follows:

> "*The proposed plan does not change the law* and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder."

It is obvious from even a cursory reading of the foregoing quotation that the italicized words are definitely qualified and limited by the phrase "where there is no change in the proportion of ownership by the shareholder." So, properly read and understood, Mr. Vinson's statement must be taken to mean that "The proposed plan does not change the law . . . in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder." That this is the proper meaning and interpretation is further evidenced by reference to the entire discussion reproduced on pages 33-34 of this brief, from which it is fair to deduce that the prior existing law provided that no tax should be levied upon any stock dividends; that such provision had its origin in the notion that under the decision of this Court in the *Macomber* case no stock dividend was taxable; that, as subsequently interpreted by this Court, the language of the earlier Statutes went further than was required by the *Macomber* decision; that the proposed language of the 1936 Act narrowed the scope of the prior existing law so as to provide explicitly that stock dividends constitutionally taxable shall be subjected to tax and stock dividends constitutionally immune from taxation shall not be subjected to tax; and that such new provisions do not strike at the decision of this Court in the *Macomber* case, as now interpreted.

Considering the change of language in Subdivision (f) of Section 115 of the Revenue Act of 1936 in conjunction with all of the other circumstances adverted to, the fact that the Statute was amended in 1936 is additional evidence

in support of the conclusion that under Section 115 (f) of the Revenue Act of 1928, all stock dividends whether or not resulting in Income to the stockholders, were exempt from tax.

The Brief of the Government.

In conclusion a word as to the general tenor of the Government's argument.

The Government does not deny that the Statute providing that "a stock dividend shall not be subject to tax" is free from ambiguity and that the term "stock dividend" by its universally accepted definition includes those stock dividends which are constitutionally subject to tax, as well as those which are constitutionally immune from tax. But it attempts to relieve itself of the consequences of being forced to this position by arguing in this fashion:

> The intent of Congress will prevail over the literal meaning of the Statute. The object of the statutory exemption "was to comply with the Constitution, as interpreted in the *Macomber* case. There is no evidence in the legislative history of the Revenue Act of 1921 or subsequent Acts of a policy behind the exemption of stock dividends other than the recognition of a constitutional limitation" and no other policy of exemption "can reasonably be imagined". That this was the object of Congress is "evidenced by the fact that in the Revenue Act of 1921 and all Revenue Acts thereafter, Congress sought to reach distributions which might otherwise be exempted under the *Macomber* case by providing that stock dividends redeemed under such circumstances as to constitute payment of a taxable dividend should be taxed as such". The "evident intent of Congress in income taxation is to use its power under the Sixteenth Amendment to the full extent. It is unreason-

able to suppose that Congress at the same time and for no apparent reasons of policy intended to exempt stock dividends which were within its taxing power." (Petitioner's brief in *Gowran* case, pp. 14-19.)

Assuming that this argument of the Government is fairly based upon and justified by the facts, which, we submit, of course, it is not, its fallacy may best be exposed by reference to the language of this Court in *Iselin* v. *United States*, 270 U. S. 245, 250:

> "It may be assumed that Congress did not purpose to exempt from taxation this class of tickets. But the act contains no provision referring to tickets of the character here involved; and there is no general provision in the act under which classes or tickets not enumerated are subjected to a tax. * * * The statute was evidently drawn with care. Its language is plain and unambiguous. What the government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function."

Whatever Congress might have done, had it been prophetic enough in 1921 to foresee the decision of this Court in 1936 in the *Koshland* case, this fact stands unchallenged by the Government in its brief: The general, if not the universal, understanding of the opinion and decision in the *Macomber* case was that the "severance test" was controlling, and that accordingly no stock dividend could be subject to tax under the Constitution. This was the understanding of the Treasury Department, which made the Regulations. This was the understanding of Congress, which passed the Revenue Act of 1921, as clearly appears from the Reports of Debates in the House prior to the passage of the Act. This was the understanding of later Con-

gresses, which re-enacted the 1921 Statute, with the repeated endorsements of the Treasury Department Regulations and a continuous administrative construction and application. This was the understanding of legal authorities both in this country and abroad, who considered and wrote upon the subject. Finally, this was the understanding of the taxpayers who, in reliance upon such construction, declared and accepted stock dividends.

It by no means follows, because an erroneous understanding of the *Macomber* decision may have supplied the *motive* for the statutory exemption of stock dividends, that the legislative *intent* was other than to exempt *all* stock dividends from taxation. If we are permitted to go beyond the plain language of the Statute, the *intent* of Congress must be ascertained from its *actual* understanding of the *Macomber* decision, whether such understanding was right or wrong. If the actual understanding was that all stock dividends were constitutionally immune from taxation, the legislative intent must have been to give complete exemption to all stock dividends. If, on the other hand, it be assumed that Congress knew that certain types of stock dividends were taxable under the Constitution, then it must be assumed that Congress deliberately exempted such stock dividends from tax, since the language of the exemption will admit of no other construction.

The original prototype of Section 115 (f) of the 1928 Act was "drawn with care. Its language is plain and unambiguous." *Iselin* v. *United States, supra.* Under such circumstances, far from there being an intent on the part of Congress differing from the literal meaning of the words exempting all stock dividends from taxation, there was a specific intention of Congress to make such exemption effective as to all stock dividends. Precise language was used to effect that intention. It avails not the Government to argue that the Treasury Department and Congress misin-

terpreted the scope of the *Macomber* decision so that Congress mistakenly, *though intentionally,* exempted all stock dividends from taxation at time of receipt. Such an argument has no relation to the construction of a statute, but, on the contrary, is a request to this court to exercise retroactively legislative rather than judicial functions. That the Government recognized this fact is best evidenced by the manner and substance of its argument before this Court in the *Koshland* case and by the fact that the Treasury Department has caused Congress, in the Revenue Act of 1936, to change the law in respect of this matter.

The principle sought to be invoked by the Government, viz, that the evident intent of Congress in income taxation is to use its power under the Sixteenth Amendment to the full extent is inapplicable. If that principle were to be applied to a case such as this, then the functions of this court in respect of all matters of taxation would be limited to determining whether or not a given transaction has resulted in the realization of income under the Constitution and, having determined this question in the affirmative, to subject such income to taxation, irrespective of or in opposition to the specific provisions of the applicable Revenue Acts.

The position of the Government in this case and in the *Gowran* case is unfortunate, both from the standpoint of those charged with the administration of the law and of the taxpayers who look to their Government for fair treatment.

Both before the Board of Tax Appeals and the Appellate Courts, the Government strongly urged both in the *Tillotson* case and in the *Koshland* case that all stock dividends were exempt from tax. Its position in those cases was consistent with the position of the Treasury Department since 1920. This Court in its decision in the *Koshland* case, as hereinbefore pointed out, held invalid the Regulations requiring the adjustment of the cost of stock on which a

stock dividend had been paid. This Court, however, in its decision in the *Koshland* case used language which seemed to leave no doubt as to its belief that Congress had made the exemption broad enough to cover all types of stock dividends. Notwithstanding this clear indication that this Court agreed with the Government's original interpretation of Section 115 (f), the Government in this case and in the *Gowran* case is now urging that it has been wrong for the past fourteen years, and is now attempting to find some hidden intent of Congress behind the simple and precise wording of Section 115 (f). Yet, as late as 1935 in its Brief before the Circuit Court of Appeals in the *Koshland* case, it said at page 17:

> "The words of the Statute, however, are broad and unambiguous, that all stock dividends are not subject to tax, and we submit there is no reason to assume that the relief from taxation is restricted to the limited class of stock dividends which are constitutionally exempt from income taxation. The words of the statute should be given their plain and generally accepted meaning."

Again as late as 1936, in its Brief in the *Koshland* case, in this Court the Government, by the same counsel who is on the Brief in this case and in the *Gowran* case, said at page 17:

> "This conclusion finds support in the fact that Congress placed no limitation or classification on the nature or type of stock dividend exempted from tax and used language which is so plain in meaning as not to justify resort to Committee Reports for ascertainment of intention."

We close this point of this Brief with the foregoing words of the Government's own Counsel in support of the position of the Respondent in this case.

POINT II.

Is a dividend of Preferred Stock paid to holders of Common Stock, when there were other shares of Preferred Stock of the same classification outstanding, taxable as Income under the Sixteenth Amendment to the Constitution?

We believe that this Court will conclude:

1. That Congress in Section 115 (f) has exempted *all* stock dividends from tax. (See Point I of this Brief.)

2. That the question of the basis to Respondent of the Preferred shares redeemed in 1931 is not properly before this Court. (See Point III of this Brief.)

But if we are mistaken on either point, it will be necessary for this Court to determine whether the dividends paid on the Common Stock in the form of Preferred shares constituted Income at the time of receipt.

This Court has directly ruled:

1. That a dividend of Common on Common does not constitute Income under the Constitution.

Eisner v. *Macomber, supra.*

2. That a dividend of Common on Preferred—there being shares of Common already outstanding—does constitute Income under the Constitution.

Koshland v. *Helvering, supra.*

To the same effect is:

Tillotson Manufacturing Company v. *Commissioner, supra.*

As pointed out by this Court in the *Koshland* decision, the distinction between the two foregoing types of stock

dividend is that in the former case "the same interest in the same corporation" was "represented after the distribution by more shares of precisely the same character", whereas in the latter case there had been "a change in the nature of the shares issued as dividends whereby the *proportional* interest of the stockholder after the distribution was *essentially* different from his former interest". (Emphasis supplied.)

Between these two extremes lies an uncharted field—covering situations, among others, where the dividend is in the form of Preferred upon Common shares with or without outstanding Preferred shares of the same or superior rank. There is also the situation where all the stock of a corporation is owned by one stockholder—in which case it seems obvious that no distribution of new or additional shares, whether of the same or a different class, to the sole stockholder effects any increase or essential change in his interest. That these intermediate factual situations involve a question of degree is evidenced by the following conclusions reached upon the subject:

1. A dividend of Preferred on Common when there is no other Preferred of the same classification outstanding has been held not to constitute Income under the 16th Amendment.

Clark v. *Commissioner*, 28 B. T. A. 1225, affd. 77 Fed. (2d) 89 (C. C. A. 3) without passing upon the Constitutional issue;

Brown v. *Commissioner*, 26 B. T. A. 901, affd. 69 Fed. (2d) 602 (C. C. A. 7) without passing on the Constitutional issue; certiorari denied, 293 U. S. 570;

Horrmann v. *Commissioner, supra.*

2. A dividend of Preferred on Common when there is other Preferred of the same classification outstanding

has been held to constitute Income under the 16th Amendment.

Torrens v. *Commissioner*, 31 B. T. A. 787; settled without decision by the Circuit Court of Appeals.

Gowran v. *Commissioner*, 32 B. T. A. 820, reversed 87 Fed. (2d) 125 (C. C. A. 7) without passing upon the Constitutional question.

The foregoing, we believe, is a complete judicial history of the interpretation by the Board of Tax Appeals, the Circuit Court of Appeals and this Court of the power of Congress to impose an Income Tax on stock dividends under the Constitution.

The principle of law, as now established by this Court, is clear, viz., that Congress may tax as Income under the 16th Amendment any stock dividend whereby the *proportional* interest of the stockholder after the distribution becomes *essentially* different from his former interest. But the application of that principle to the various intermediate factual situations presents serious difficulties.

That Congress recognizes that there is still doubt as to just what stock dividends constitute Income is shown by the provisions of the Revenue Act of 1936 (Sec. 115 (f)). Instead of a simple provision taxing any dividend paid by a corporation in shares of a classification or preference different from the shares on which the dividend is paid, Congress avoided the issue by providing that stock dividends shall be taxed to the extent that they constitute Income within the meaning of the 16th Amendment.

Certain it is that in the *Koshland* case the receipt by the taxpayer of Common Shares as a dividend did not diminish in any respect the taxpayer's interest in her Preferred Stock. The Preferred Stock continued to possess the same preferences and to have the same value as it had

prior to the distribution of the Common Stock dividend. Thus, the taxpayer's interest in the corporation was increased both absolutely and proportionately to the extent of the fair market value of the Common Shares issued as a dividend upon her Preferred Stock.

Equally certain it is that in the instant case the receipt by this Taxpayer of her Preferred Stock dividend neither increased nor essentially changed her absolute or proportional interest in the corporation, since its immediate and necessary effect was to dilute and diminish the value of her Common Stock interest to the exact extent of the par value of her Preferred dividend shares. This fact can be mathematically demonstrated. Since these Preferred shares were issued ratably to the Common stockholders, the practical effect upon each such stockholder was simply to subordinate his holdings of Common Stock, both as to dividends and distribution of assets, to that proportionate part of the new issue of Preferred which was distributed to him.

In the instant case the same corporation continued in existence, under the same management and with the same officers, and transacted the same business in precisely the same fashion as prior to the distribution of the Preferred Stock dividend. The voting rights remained unchanged, the Preferred Stock having no vote.

The interests of the four Warner common stockholders after they received their Preferred Stock dividends were substantially the same as before they received such dividends. They did not become creditors of the Corporation and their potential cash dividends from the Corporation were no greater than before, because, as Common stockholders, they had possessed complete control over the finances of the Corporation and could have caused dividends to be paid to themselves on their Common Stock in an amount equal to the dividends which would be paid on their

combined Common and Preferred Stocks after the Preferred Stock dividends had been declared.

The large earnings of the Corporation during its entire existence seemed to assure the ability of the Corporation to pay out of current earnings the comparatively small preferential dividends on its newly issued as well as on its already outstanding Preferred Stock. Its capital together with its large and constantly increasing surplus still further assured the ability of the Corporation to pay in full the preferential claims of all the Preferred stockholders in the remote contingency of liquidation. In the light of the foregoing conditions, the Common stockholders of the Warner Corporation received as a result of the Preferred Stock dividend nothing which added to the value of that which they already had; while, in the *Koshland* case, the Preferred stockholders received as a result of the Common Stock dividend something which added to that which they already had, their interest in the Corporation having been increased to the extent of the full value of the Common Shares which they received.

The preferences inherent in the Preferred Stock received as a dividend in the instant case would be of value *only* in case of great and unlikely decrease in corporate earnings and surplus. At the time of the distribution of the Preferred Stock dividend, the preferences involved were of no actual value because the Warner Corporation had a surplus amply sufficient to meet its dividend requirements. If the Warner Corporation had been liquidated immediately after the receipt of the Preferred Stock dividend, the stockholders who received such dividend would have participated to that extent in the assets of the Corporation as Preferred stockholders and consequently to an equivalently lesser extent as Common stockholders. The aggregate amount, therefore, which each stockholder would have received upon

liquidation, whether or not a Preferred Stock dividend had been declared, would have been precisely the same.

The foregoing illustrates the fundamental difficulty inherent in determining what stock dividends in the intermediate factual situations constitute Income. We have not only the question as to what degree of change in the proportionate interests of stockholders is necessary to meet the test that Income is realized, but the further question as to what is the measure of the Income when that which is received is taken from that which was had before.

In view of all the circumstances and facts present in the instant case, it is submitted that the distribution of the Preferred Stock dividend did not essentially change the Taxpayer's interest in the Warner Corporation. Any change which may have resulted certainly can not be measured by the full value of the Preferred Stock received.

POINT III.

The Circuit Court of Appeals correctly refused to consider (1) the contention of the Commissioner that the shares of Stock redeemed in 1931 had a zero basis, and (2) the alternative contention of the Commissioner that such Shares were Taxable as a Dividend under Section 115 (g) of the Revenue Act of 1928.

1. In 1928 the Taxpayer received as a dividend upon her Common Stock of the Warner Corporation 12,582 shares of Preferred Stock of that Corporation. Subsequently, in 1931, the Corporation redeemed 2,000 of these shares, paying the Taxpayer therefor the sum of $200,000.

As provided in the Treasury Regulations then in effect requiring apportionment, the Taxpayer reported as capital gain in her Federal Income Tax Return for the year 1931 the sum of $180,100, approximately 90% of the $200,000 received from the redemption of her preferred stock, and paid

a capital gain tax of 12½% thereon. The Commissioner, in his Notice of Deficiency, eliminated the said sum of $180,100 from the gross and net Income of the Taxpayer and credited the Taxpayer with the 12½% tax so paid. The Commissioner, in his Notice of Deficiency, claimed that the amount of $200,000 received by the Taxpayer from the redemption of her preferred stock constituted a taxable dividend under the provisions of Section 115 (g) of the Revenue Act of 1928, and increased her gross and net Income by that amount. Clearly, therefore, the question of the taxability as capital gain of the $200,000, or any part thereof, was not an issue before the Board of Tax Appeals and was not, in fact, decided by the Board.

The Board held that the Taxpayer was not subject to taxation under the provisions of Section 115 (g) of the Revenue Act of 1928 upon the proceeds of the redemption of the 2,000 shares of Preferred Stock. The Board said:

> "The Commissioner held that the redemption of the 2,000 shares in 1931 was at such time and in such manner as to be substantially equivalent to a taxable dividend in 1931, within the meaning of section 115(g) of the Revenue Act of 1928. He erred in this since the dividend was subject to tax in 1928 (see cases above cited). Thereafter the shares had a basis for gain or loss to the petitioner of $100 each, and they were redeemed without gain or loss to the petitioner at $100 each in 1931." (R. 36).

In the brief which the Commissioner filed with the Circuit Court of Appeals, he contended *for the first time* that, if the dividend received by the Taxpayer in 1928 was *exempt from tax at the time of receipt,* under Section 115 (f), its basis to the Taxpayer was zero. The Circuit Court of Appeals refused to consider this point on the ground that:

> " • • • the issue was not raised before the Board nor decided by it nor assigned as error in the peti-

tion to this court for a review of the Board's decision * * *."

2. As an alternative contention, the Commissioner urged in his brief in the Circuit Court of Appeals that, if the 2,000 shares of stock redeemed in 1931 did not have a zero basis, such shares were taxable as a dividend under Section 115 (g) of the Revenue Act of 1928. The Circuit Court of Appeals also refused to consider this point upon the ground that "the Commissioner did not file a cross appeal". In addition the Court stated:

> "By the provisions of section 115 (g) the proceeds of the redemption of the stock can be taxed only if it occurs at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend. Since the Board did not so find, we cannot support this contention. (Helvering v. Rankin, 295 U. S. 123)."

It should be borne in mind that in the Deficiency Notice herein the Commissioner determined a deficiency of $125,660.67, by reason of adding to the Taxpayer's net income:

(1) $629,125.00, representing the value of the 1931 stock dividend, upon the stated ground that such dividend was taxable under Section 115 (f).

(2) $200,000.00, representing the proceeds of redemption of 2,000 shares, upon the stated ground that such redemption was taxable under Section 115 (g).

The Taxpayer thereupon appealed to the Board of Tax Appeals for a redetermination of the two foregoing issues. The Board sustained the Commissioner as to the issue concerning the item of $629,125.00, but overruled the Commissioner as to the issue concerning the item of $200,000.00,

and the result thereof was a determination of a deficiency against the Taxpayer in the sum of $89,841.75.

Thereafter the Taxpayer filed a petition with the Circuit Court to review the adverse determination of the first issue. The Commissioner filed no cross-appeal to the Circuit Court as to the second issue which had been determined by the Board adversely to him.

The Commissioner now contends that the Circuit Court of Appeals erred in refusing to pass upon these two alternative points.

That the Circuit Court of Appeals was correct in refusing to consider either of these points is well settled. A Respondent who does not take a cross-appeal nor assign errors cannot raise alleged errors in the Circuit Court of Appeals.

As stated by the Circuit Court of Appeals for the First Circuit in *Swig* v. *Tremont Trust Co.*, 8 Fed. (2d) 943, 945:

> "But the trust company did not except to this ruling, so far as the record shows, and has filed no cross-appeal and assignment of errors complaining of it. We are therefore of the opinion that this question is not before us."

Consequently, the Court below properly refused to consider the applicability of Section 115 (g) of the Revenue Act of 1928.

In any event, there are no facts before this Court upon which to base a judgment on the question involved and, as the application of Section 115 (g) is solely a factual question, we will not discuss it further in this brief.

Even more clearly, the contention that the basis of the shares received by the Taxpayer in 1928 was zero was not before the Circuit Court for consideration, since not only was this contention not properly presented to the Circuit Court, but it was not even suggested to the Board.

The Commissioner, in support of his contention that the question of the basis was at issue before the Board, quotes a portion of the opinion of the Board in which the Board said that "the shares had a basis for gain or loss to the petitioner of $100". This statement of the Board, however, was not made in discussing or deciding the issue of the zero basis. This statement was made to fortify the conclusion that the sum of $200,000 was not subject to taxation as a dividend under Section 115 (g). The Board did not undertake to decide whether or not the Taxpayer derived a capital gain from the redemption of the 2,000 shares and did not, in its opinion, imply that this issue was before it for review.

In *General Utilities & Operating Company* v. *Helvering*, 296 U. S. 200, 206, the Court ruled in an identical situation:

> "The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him."

Helvering v. *Salvage*, 297 U. S. 106, 109, is to the same effect.

The cases cited by the Government on the proposition that any argument may be offered in support of the judgment below have no application. The Government is seeking here, not to support the judgment of the Board, but to have this Court reverse the determination of the Board in respect of an issue (Section 115 (g)) that was decided adversely to the Government and further, to have this Court consider and decide the question of the cost basis of shares of stock—an issue not presented to the Board.

Since neither the point that the redemption of Taxpayer's shares in 1931 was taxable as a dividend under

Section 115 (g) of the Revenue Act of 1928, nor the point that such shares had a zero basis was properly before the Circuit Court of Appeals, neither point can be urged by the Commissioner in this Court as a ground for reversal.

POINT IV.

The Basis to the Taxpayer of the Preferred Stock, received by her as a dividend in 1928, is the Fair Market Value of such stock at date of receipt.

Assuming that the issue as to the basis of the preferred stock was properly raised in the Board of Tax Appeals and in the Circuit Court of Appeals, and assuming further that the stock dividend constituted Income, it is submitted that, on the merits of the question, the basis of these shares is their fair market value at the time of receipt by the Taxpayer.

The Government will concede, we assume, that, if Section 115 (f) did not exempt from taxation the stock dividend received by the Taxpayer in 1928, the basis of the dividend shares was their fair market value. The contention of the Government that the basis of the dividend shares is zero is predicated entirely upon the proposition that, if these shares were exempt from tax when received, the full amount realized by the Taxpayer upon their disposition should be subjected to tax. But as pointed out by this Court in the *Koshland* case:

> "Whether Congress has taxed 'the dividend' as of the time of its receipt, is immaterial."

That this is so is clear from the fact that the argument offered by the Government in support of the contention that the basis of the shares in question was zero is grounded upon the principle that the Taxpayer acquired these shares "without any new investment". But no "new investment"

is made by the recipient of a *taxable property dividend.* If, therefore, the zero basis theory depends upon the no "new investment" principle, the recipient of a taxable property dividend would be subject to taxation upon the full value thereof at the time of its receipt and again at the time of the sale or disposition of the property so received. The utter fallacy of the Government's argument is thus exposed.

Section 113 of the Revenue Act of 1928 expressly declares that the statutory basis for determining gain or loss from the sale or other disposition of property is its "cost" (*Koshland* v. *Helvering, supra*). Where property is acquired by purchase the term "cost" is synonymous with the term "purchase price", but this Court has expressly held that where property does not have a "cost" in the conventional sense and the applicable Revenue Act does not prescribe otherwise, the basis of the property is the fair market value thereof at the time of acquisition by the taxpayer. In *Hartley* v. *Commissioner,* 295 U. S. 216 (1935), the Court said:

> "The Court of Claims held that the time of acquisition, indicated by Sec. 202 (a) of the 1921 Act and Sec. 204 (a) of the 1924 and 1926 Acts as the controlling date for calculating gain or loss to the estate in the course of administration, must be taken to be the date of acquisition by the decedent rather than the time of acquisition by the executor or administrator on the decedent's death. This conclusion, it was thought, was compelled by the statutory command that the basis of computation shall be 'cost', which could have no application to the acquisition by the executor or administrator, who is not a purchaser of the estate which he administers. McKinney v. United States, supra (62 Ct. Cl. 188). But this specification is not enough to restrict the effect of the general provisions of these revenue acts which impose a tax on the income, including capital gains, of taxpayers. *The*

use of the word cost does not preclude the computation and assessment of the taxable gains on the basis of the value of property, rather than its cost, where there is no purchase by the taxpayer, and thus no cost at the controlling date. See Heiner v. Tindle, 276 U. S. 582, 585, 586, 72 L. ed. 714, 716, 717, 48 S. Ct. 326; Lucas v. Alexander, 279 U. S. 573, 578, 579, 73 L. Ed. 851, 854, 855, 49 S. Ct. 426, 61 A. L. R. 906." (Emphasis supplied.)

The case of *Heiner* v. *Tindle*, 276 U. S. 582, which arose under the Revenue Act of 1918, involved the sale of a dwelling house originally acquired and used by the taxpayer as his residence, but which had subsequently been leased by him. The sale of the property resulted in a loss. The property had been leased prior to March 1, 1913, and the question considered by this Court was whether the basis for determining the taxpayer's loss should be the fair market value of the property as of March 1, 1913, or the fair market value in 1901 when the property was first leased. This Court decided that if the 1901 value was less than the value of the property in 1913, the value at the earliest date represented the basis for determining the loss. In the course of its opinion, this Court said:

> "But it is pointed out that sec. 202 of the Revenue Act of 1918, prescribing the method of computing gain or loss upon the sale of property, makes value as of March 1, 1913, or cost if acquired later, the basis of the computation. * * *
>
> "But it is obvious that sec. 202 is not all inclusive. The same and no greater inconsistency and difficulty arise in the case of property acquired by gift, bequest or devise, when market value at the time of acquisition by the donee and not cost is necessarily the basis of computing the tax. That in such cases the difference between the sale price and market value at the date of acquisition, if after March 1, 1913, is deductible under subsection (a) 5, is not questioned."

This rule that the basis of property acquired otherwise than by purchase—in the absence of an express statutory provision prescribing some basis other than "cost"—is the fair market value of such property when acquired, is so well established as to be virtually axiomatic. The principle has been consistently recognized by the Board of Tax Appeals and the Courts, and has been applied to a variety of situations, irrespective of whether the acquisition of the property resulted in taxable income. *Francis* v. *Commissioner*, 15 B. T. A. 1332; *Bankers Trust Company* v. *Commissioner*, 24 B. T. A. 10; *Lucas* v. *Daniel*, 45 Fed. (2d) 58 (C. C. A. 5); *Gowran* v. *Commissioner, supra*, now pending before this Court on Writ of Certiorari.

The Government applied this same principle in Regulations 45, Article 1562 (relating to the Revenue Act of 1918) to property acquired by gift, bequest, devise or descent—the Revenue Act of 1918 prescribing no exception to the general rule that the basis of property so acquired after February 28, 1913, is its "cost". The Article just referred to reads as follows:

> "In the case of property acquired by gift, bequest, devise or descent, the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition. * * *"

To the same effect is G. C. M., 2861, C. B. VII-1, 255.

The Koshland Case.

The Commissioner contends that the conclusion that the basis of the preferred shares is zero seems to follow from the decision of this Court in the *Koshland* case. Just how the decision in the *Koshland* case can be regarded as authority for the Commissioner's present contention is not clear. In the *Koshland* case the taxpayer acquired certain shares of preferred stock by *purchase*. Subsequently, the tax-

payer received a dividend upon these shares in the form of common stock in the same corporation. The original (preferred) shares were later sold. *This* Court held that the basis of such shares could not be reduced by allocating a portion of their cost to the common shares received as a dividend. It was consequently held that the "cost" of the original preferred shares—the amount paid therefor by the taxpayer—represented the proper basis of such shares to the taxpayer as prescribed by the Statute (Section 113, Revenue Act of 1928). The only question presented to this Court in the *Koshland* case was the correct basis of the *original shares;* the question as to the basis of the *dividend shares* was not even inferentially considered by this Court in that case.

Clearly, therefore, the *Koshland* decision lends no support to the contention that the Taxpayer has a zero basis for the Preferred shares received by her as a dividend upon her Common stock in William R. Warner Corporation. Indeed, the principle of the decision in the *Koshland* case compels a contrary conclusion.

The rule that, where property is acquired otherwise than by purchase, the "cost" of such property is its value when acquired has thus become definitely established. Regardless of how property is acquired, whether by purchase, gift, descent or corporate distribution, it becomes new capital in the hands of the recipient. Only the gain subsequently derived from such capital, including the profit realized from a sale of the capital asset, is income and taxable as such.

The shares of preferred stock received by the Taxpayer as a dividend in 1928 had a value of $100 per share (R. 16). Since the price at which these shares were redeemed was the same as the value thereof when acquired by the Taxpayer, it follows that no gain or loss resulted to the Taxpayer upon the redemption of her preferred shares.

Conclusion.

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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Dated: New York, New York.
October 15, 1937.

APPENDIX.

REVENUE ACT OF 1921:

Section 201. • • •

"(d) A stock dividend shall not be subject to tax but if after the distribution of any such dividend the corporation proceeds to cancel or redeem its stock at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount received in redemption or cancellation of the stock shall be treated as a taxable dividend to the extent of the earnings or profits accumulated by such corporation after February 28, 1913."

REVENUE ACT OF 1928:

Section 115. Distributions by Corporations.

"(a) Definition of dividend.—The term 'dividend' when used in this title (except in Section 203 (a) (4) and Section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

• • • • • • • • •

(f) *Stock dividends*—A stock dividend shall not be subject to tax.

• • • • • • • • •

Section 201 (a) of the Revenue Acts of 1924 and 1926 and Sections 115 (a) of the Revenue Acts of 1928, 1932 and 1934 are substantially identical with subdivision (a) of Section 115 of the Revenue Act of 1928.

• • • • • • • • •

Sections 201 (f) of the Revenue Acts of 1924 and 1926 and Sections 115 (f) of the Revenue Acts of 1928, 1932 and 1934 are identical with Section 115 (f) of the Revenue Act of 1928.

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 29

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

ANNIE M. PFEIFFER.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

PETITION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE.

J. HARRY COVINGTON
JOHN THOMAS SMITH
PAUL E. SHORB
DAVID SHER

Washington, D. C.
October 19, 1937.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C

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PETITION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

The undersigned respectfully petition this Court for leave to file this brief as *amicus curiae* in the above entitled suit. The Solicitor General of the United States and counsel for the respondents have assented to the filing of this brief, and their written assents are filed herewith.

J. HARRY COVINGTON,
JOHN THOMAS SMITH.

Washington, D. C.
October 19, 1937.

IN THE

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ANNIE M. PFEIFFER.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF OF AMICUS CURIAE.

The sole question considered in this brief is whether Section 115(f) of the Revenue Act of 1928 (Act of May 29, 1928, c. 852, 45 Stat. 791) exempts all stock dividends from income tax.

The facts upon which this case arises are not in dispute and are fully set out in the briefs of the respective parties. This brief, therefore, will confine itself to the argument on the above question.

SUMMARY OF ARGUMENT.

I.

The term "stock dividend" used in Section 115(f) of the 1928 Act has always meant a distribution of the stock of a corporation among its stockholders as a dividend. This clear and simple definition has constantly been used not only by the text-writers and the courts, but also by the Treasury Department and by Congress itself. Under these circumstances, the Court should apply the familiar canon of construction that where the language of a statute admits of but one meaning, it will be enforced according to its terms. *Wallace* v. *Cutten*, 298 U. S. 229, 237.

II.

The plain meaning of the statute is confirmed, if confirmation be necessary, by the actual debates in Congress on the various bills dealing with the exemption of stock dividends. Those debates show a reluctance to exempt stock dividends, but a clear intention to grant them full exemption because of the belief that the decision in *Eisner* v. *Macomber*, 252 U. S. 189, left no alternative,—a belief that was fostered both by contemporary discussions of that decision and by the decisions of the Treasury Department.

The plain meaning of Section 115(f) of the 1928 Act is still further confirmed by the change in the language of that section in the 1936 Act. The latter exempts only those stock dividends which are not income under the Sixteenth Amendment, and is strong evidence that the law was changed by the 1936 Act. *Brewster* v. *Gage*, 280 U. S. 327, 337. The legislative history of the 1936 Act indicates clearly that a change in the law was intended, rather than a clarification of the old law, and this indication is confirmed by the Act itself in Section 115(h).

The Government's principal argument is that the exemption of stock dividends was purely a recognition by Congress of the constitutional limitation announced by *Eisner*

v. *Macomber, supra.* Conceding this to be true, the answer is that the constitutional limitation was thought to cover *all* stock dividends. Moreover, the Government attempts to impart to Congress information which it did not have in 1921 and interprets the statute in the light of later events rather than in the light of circumstances that were assumed to exist at the time the statute was enacted. This Court has frequently held that this may not be done. *Merritt* v. *Walsh,* 104 U. S. 684, 700; *Platt* v. *Union Pacific R. R. Co.,* 99 U. S. 48, 63-64.

ARGUMENT.

I.

The Plain Meaning of the Provision Must Be Obeyed.

The language of Section 115(f), "A stock dividend shall not be subject to tax", is clear and unambiguous. There never has been any doubt that a stock dividend, in contrast to a cash or property dividend, means a distribution by a corporation of its own stock as a dividend to its stockholders. "A stock dividend is what the term itself implies, a distribution of the stock of the corporation among the stockholders as a dividend." Thompson on Corporations, Vol. 7, Section 137. "A stock dividend is a dividend payable in reserved or additional stock of the corporation instead of in cash or in property." Fletcher, Cyclopedia of Corporations, (1919 ed.) Vol. 6, page 6122. These and similar definitions have frequently been applied by the courts. See *Gray* v. *Hemenway,* 212 Mass. 239, 242 (1912); *DeKoven* v. *Alsop,* 205 Ill. 309, 314 (1903); *Union & New Haven Trust Co.* v. *Taintor,* 85 Conn. 452, 455 (1912). Any suggestion that the scope of the term "stock dividend" is limited to a dividend of common stock to common stockholders is quickly dispelled by a simple *reductio ad absurdum.* Suppose that an early Revenue Act had provided that "a stock dividend *shall* be included in the computation of gross income". Would anyone have dared to contend that the term em-

braced only a dividend of common stock to common stockholders and that a dividend of preferred stock to common stockholders, for instance, was outside its ambit?

Prior to the original adoption of the stock dividend exemption in 1921, the Treasury Department had used the term "stock dividend" to describe any issue of stock by a corporation to its stockholders, whether of the same class or not. T. D. 3052 and 3059, 3 C. B. 38 (August 1920). "A stock dividend paid in true preferred stock is exempt from tax the same as though the dividend were paid in common stock." O. D. 801, 4 C. B. 24 (January-June 1921). It used the term in that sense after the enactment of the exemption. Article 1548 of Regulations 62, 65 and 69; Article 628 of Regulations 74 and 77; Article 115-8 of Regulations 86. It continues to use the term in the same sense after *Koshland* v. *Helvering*, 298 U. S. 441. "The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution . . ." Article 115-7 of Regulations 94 (Nov. 12, 1936).

Congress itself has always used the term "stock dividend" interchangeably with "dividend in stock". Section 2 (a) of the Revenue Act of 1916 (Act of September 8, 1916, c. 463, 39 Stat. 756) provided that the term "dividend" should mean "any distribution . . . in cash or in stock of the corporation, . . . which stock dividend shall be considered income to the amount of its cash value". Section 31 (a), added to the 1916 Act by Section 1211 of the Revenue Act of 1917, (Act of October 3, 1917, c. 63, 40 Stat. 300), and Section 201 (a) and (c) of the Revenue Act of 1918 (Act of February 24, 1919, c. 18, 40 Stat. 1057), contain similar provisions. H. R. 14197, adopted by the House in the 2nd Session of the 66th Congress, contained the same significant phraseology—"A dividend paid in stock of the corporation (hereinafter called 'stock dividend') . . . ". Section 115(f) of the Revenue Act of 1936 (Act of June 22, 1936, c. 690,

49 Stat. 1648), adopted after *Koshland* v. *Helvering,* still uses the term in the same sense.

Throughout the kaleidoscopic statutory and administrative changes wrought by *Towne* v. *Eisner,* 245 U. S. 418, *Eisner* v. *Macomber,* 252 U. S. 189, and *Koshland* v. *Helvering,* the meaning of the term "stock dividend" remained ever constant as a description of that category of corporate dividend in which stock of the corporation rather than cash or property is distributed to the stockholders.

The definitive and unmistakable words, "a stock dividend shall not be subject to tax", call into play the familiar canon that where the language of a statute admits of only one meaning, the court will enforce it according to its terms. *Helvering* v. *City Bank Farmers Trust Co.,* 296 U. S. 85, 89; *Crooks* v. *Harrelson,* 282 U. S. 55, 58; *Thompson* v. *United States,* 246 U. S. 547, 551; *United States* v. *Goldenberg,* 168 U. S. 95, 103; *Sturges* v. *Crowninshield,* 4 Wheat. 122, 202-203. The principle is not a product of pedantry but of a keen realization of the method most surely calculated to carry out the legislative intent. What Congress says is the best evidence of what Congress means.

Wallace v. *Cutten,* 298 U. S. 229, is a fine symbol of judicial fidelity to legislative language. Section 6(b) of the Grain Futures Act provides that if the Secretary of Agriculture has reason to believe that any person "is violating" any provision of the Act, the Secretary may serve a complaint upon that person requiring him to show cause why he should not be suspended from trading. The complaint in the case alleged violations which had been completed before the complaint was filed. The Government argued that, since violations by their very nature could not be detected during the course of commission, a literal construction given to Section 6(b) would render it impractical and ineffective. Mr. Justice Brandeis for a unanimous court disposed of this contention in the following succinct and signficant paragraph (p. 237):

> "It would be inappropriate for us to discuss these, and other, arguments presented. The language of § 6 (b) is clear; and on the face of the statute, there can be no doubt concerning the intention of Congress. As was said in *Iselin* v. *United States,* 270 U. S. 245, 250-251: 'The statute was evidently drawn with care. Its language is plain and unambiguous. What the Government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably (possibly) by inadvertence, may be included within its scope. To supply omissions transcends the judicial function.' "

The words of Section 115(f) of the Revenue Act of 1928 decree an exemption for all stock dividends, irrespective of class or category. They must be obeyed. Otherwise, taxpayers will have been misled for a period of fifteen years.

II.

The Legislative History of the Provision Confirms Its Literal Meaning.*

Eisner v. *Macomber,* decided on March 8, 1920, was received alike by those who acclaimed and those who deplored it as standing for the proposition that payment from the corporate treasury is an indispensable incident of a taxable dividend.

> "The essential and controlling fact," run the celebrated words of Mr. Justice Pitney, "is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains

*The rule restricting the use of debates does not apply when the purpose is to sustain the literal meaning of a statute. *United States* v. *Missouri Pacific Railroad Company,* 278 U. S. 269, 278.

Use of debates is proper also to show the circumstances prompting the legislation. *Humphrey's Exec.* v. *United States,* 295 U. S. 602, 625; *Federal Trade Commission* v. *Raladam,* 283 U. S. 643, 649-650.

> the property of the company, and subject to business risks which may result in wiping out the entire investment." *Eisner* v. *Macomber,* 252 U. S. 189, 211.

Authorities on constitutional law were unanimous in their construction of the decision. Writing in the Columbia Law Review for May 1920, (Vol. 20, p. 536) Professor Thomas Reed Powell declared at pages 542, 545:

> "The determining reason why a stock dividend is not income is that the corporation parts with nothing. Its assets remain intact. Therefore, a stockholder gets nothing . . . "
>
> . . . . .
>
> "So on the question of precedent and legal analysis the line of division is whether the corporation parts with assets. What is income to the stockholder depends upon what is outgo to the corporation. The majority plant themselves firmly on this ground."

In 21 Columbia Law Review 313 (1921), Mr. Eustace Seligman, analyzing the implications of *Eisner* v. *Macomber,* observed at pages 318, 319:

> "So far as the economic principle in question is concerned, all such cases resolve themselves into the simple question: Has something been taken from the corporation's assets and given to the stockholders. If so, the stockholder has received income; if not, he has not received income.
>
> . . . . .
>
> "Another application of this test of separation is that stock dividends payable to preferred stockholders are not income . . . When such stock dividends are declared, the preferred stockholders are enriched to just the same extent as if they received cash; they have received valuable new rights. Yet on the payment-from-treasury test of income, we are forced to the conclusion that they have received no income.
>
> "Another similar application of this principle is where a dividend to common stockholders is paid in preferred stock, when there has already been a pre--

existing preferred stock outstanding owned by others . . . upon the Court's test of separation, there is no income because nothing has been taken from the corporate treasury."

Writing in 35 Harvard Law Review, 363, in February 1922, Professor Powell endorsed Mr. Seligman's views (p. 377):

"Mr. Seligman is sound in his analysis that the separation test of the Stock Dividend Decision precludes the imposition of an income tax on dividends in preferred stock or in bonds of the declaring corporation . . .".

Similar opinions were voiced by Professor Charles E. Clark in an article entitled "*Eisner* v. *Macomber* and More Income Tax Problems", 29 Yale Law Journal 735, May 1920:

"The long awaited decision of the United States Supreme Court in *Eisner* v. *Macomber,* (1920) 40 Sup. Ct. 189, has aroused perhaps more interest than is merited by the actual decision, which is simply that dividends of a corporation declared by issuing its own stock are not income within the meaning of the Sixteenth Amendment."

Economists concurred with lawyers in their interpretation of the decision. Professor F. R. Fairchild of Yale, discussing the stock dividend decision in 5 Bulletin National Tax Association, pages 208, 210 (1920), remarked:

"Has something been taken from the corporation's assets and given to the stockholders? If so, the stockholder has received income; if not, he has not received income."

Congress itself was not slow to react to the impelling mandate of Mr. Justice Pitney's language. On May 22, 1920, a bill was introduced in the House of Representatives (H. R. 14197, 66th Congress, 2nd Session) carrying an

amendment to Section 201 (c) of the Revenue Act of 1918, providing as follows:

> "A dividend paid in stock of the corporation (hereinafter called 'stock dividend') shall not be subject to tax at the time of distribution."

The discussion on the floor on May 27, 1920, gives content to the words of the section (Cong. Rec., Vol. 59, pp. 7759-7760).

> MR. GREEN of Iowa [Ranking majority member of the Ways and Means Committee]. In view of the decision. It is the logical result of the decision in the Stock Dividends case. That case, I might say, declared in effect that a stock dividend could not be taxed, because it was not in fact a distribution of any property of the corporation. . . .
>
> . . . . . .
>
> MR. WINGO. Does the gentleman care to state—a good many people are inquiring—what is the probability of legislation that might reach the stock dividends that would be compatible with the decision of the Supreme Court? Is there any probability of that?
>
> MR. GREEN of Iowa. We have in the Soldiers' Adjusted Compensation Bill a provision about which I think there is no question as to constitutionality. It does not tax the stock dividend, however, in the hands of the party to whom it is issued but puts an excise tax on the corporation issuing the stock dividend.
>
> MR. WINGO. If it is issued, you put an excise tax on the issuance of that stock?
>
> MR. GREEN of Iowa. Yes; but that is not in this Bill.

It appears, therefore, that the House was satisfied the Supreme Court decision had completely deprived it of the power of treating a stock dividend as taxable income to the recipient. Its hope of recouping the revenue loss caused thereby lay in a different direction—the possibility of imposing a corporate excise tax on the issuance of stock dividends.

Although H. R. 14197 did not pass the Senate, its history reveals the state of the legislative mind as well as the interpretation commonly placed upon *Eisner* v. *Macomber*. The taxation of all stock dividends as income was thought to have been outlawed.

The reluctance of Congress to grant the immunity, with the clear inference that Congress granted it in unlimited form only because it believed *Eisner* v. *Macomber* left no alternative, is even more evident in a contemporaneous Senate debate. Representatives and Senators chafed under the immunity and acceded only on the assurance that the Supreme Court decision left no alternative except complete exemption of stock dividends. (Cong. Rec., Vol. 59, p. 7289-7290):

> MR. NELSON. If I understand the decision of the Supreme Court correctly, it practically holds that we have no right to tax stock dividends for the reason that they are capital. . . .
>
> . . . . . .
>
> MR. THOMAS. The majority opinion of the Supreme Court also holds that the transformation of income into capital stock relieves it from the burden of further taxation as income; in other words, that as soon as the transformation is complete then the fund becomes capital and ceases to be income. . . .
>
> MR. KENYON. . . . There ought to be some way of reaching those stock dividends. If the distinguished Senator from Colorado [Mr. Thomas], one of the ablest lawyers in this body, and I would say one of the greatest Senators who ever sat in this body, cannot devise some way in the Finance Committee—he was a member of that Committee when the present law was framed—to cover this question, I would despair of its being covered; but it does seem as if there should be some way of reaching the question. . . .

In the House on August 18, 1921, when the Revenue Act of 1921 was under consideration, the following colloquy occurred (Cong. Rec., Vol. 61, p. 5287):

MR. GREEN. [Ranking majority member of the House Ways & Means Committee] I explained the previous amendment very clearly, to the effect that we could not tax stock dividends any more on account of the Supreme Court decision. . . .

. . . . . .

MR. LONDON. What has the Committee substituted for the stock dividends?

MR. GREEN. We have not substituted anything.

MR. LONDON. There was no effort made to reach the stock dividends?

MR. GREEN. There is no way in which the stock dividends can be taxed under the Supreme Court decision. A different kind of a tax, of course, could be imposed.

MR. LONDON. But the Committee has not found any way to do so?

MR. GREEN. No.

In the Senate on October 19, 1921, similar sentiments were voiced. (Cong. Rec., Vol. 61, pp. 6473-6474.)

MR. NELSON. . . . stockholders of these wealthy corporations got relief under the decision of the Supreme Court holding stock dividends to be immune from taxation. Where these big companies now have big earnings, instead of distributing dividends in the shape of cash they can issue more stock, and under the decision of the Supreme Court, a 5 to 4 decision, they can escape taxation on that stock. If a dividend is paid in cash, it is taxable. If additional stock is issued—and we have cases here where they have issued eight, nine, and ten hundred per cent of stock dividends—they are immune from taxation.

. . . . . .

Mr. President, I certainly think we ought to have legislation that would put stock dividends on a par with cash dividends. . . . I have been in hopes that there would be something in this Bill which would cover that question. I think it can be covered by proper legislation.

I have inquired of the members of the Committee, and I have inquired of some of the experts we have here, whether there is a provision made for it in the

bill, and I am told that there is not. I think one of the great lapses and oversights in the bill is that it does not seek to overcome the vice of that decision of the Supreme Court of the United States about stock dividends.

MR. MCCUMBER [Ranking majority member of Finance Committee]. *If the Senator will read the Supreme Court decision carefully, he will find that the reason given for holding that you could not levy a tax upon the undistributed profits of a corporation even though they were in the form of dividend certificates, was that the taxpayer was not in possession and control of the funds, and he could not be taxed upon funds which were not his, and over which he had no control.* That was the basis of the decision, and that being the basis of the decision, you could not by any character of language tax those funds while they were still in the hands of the corporation. You could not tax them as against the holder of the certificates. *That, I think, was the reason which actuated every member of the committee, so far as I know.* The Senator from New Mexico, perhaps, was not present when that was passed upon. [Italics supplied]

Two minority reports were written in the Senate Finance Committee when the Revenue Act containing the stock dividend exemption was returned to the Senate, bitterly assailing the Bill for shifting the tax burden from those best able to bear it. S. Rep. No. 275, 67th Cong., 1st Sess. But not one word was addressed to the all-embracing scope of the stock dividend provision. Not one word was uttered to the effect that the provision was broader than it needed to be under *Eisner* v. *Macomber*. Would this gap have gone unchallenged if there were the slightest belief on anyone's part that there was any gap? The inevitability of exempting all stock dividends was the force moving Congress to approve the exemption.

The suggestion that the mind of Congress did not advert to the possibility of other types of stock dividends than common shares distributed to common stockholders involved in *Eisner* v. *Macomber* and that, therefore, the

words "stock dividend" merely embody such stock dividends as were known at the time, is confuted not only by the intervening Treasury Department rulings which specifically dealt with dividends in different classes of stock, but indeed by the dissenting opinion of Mr. Justice Brandeis in *Eisner* v. *Macomber*, 252 U. S. 189, which discussed in some detail, on page 227, the taxability of dividends paid in preferred stock to common stockholders. In spite of this caveat, the language of the majority opinion seemed so overwhelming that it is little wonder Congress did not see fit to constrict the exemption. In any event, no one can be heard to say that Congress legislated without knowledge of the existence of other forms of stock dividend than the familiar variety of common on common.

The character of the earlier exemption is brought into bold relief by the Revenue Act of 1936 which, in Section 115 (f) (Act of June 22, 1936, c. 690, 49 Stat. 1648), changed the language which had been in the Revenue Act since 1921. That section provided:

> (1) *General Rule.* A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

The specific recognition contained in this section of the different types of stock dividends, and the specific limitations of the tax exemption to the stock dividends which were constitutionally exempt—both features of which are new in the 1936 Act—are strong additional evidence that a change was intended in the 1936 Act. *Brewster* v. *Gage*, 280 U. S. 327; 337; *Johnson* v. *United States*, 225 U. S. 405, 415; *Crawford* v. *Burke*, 195 U. S. 176, 190; *Pirie* v. *Chicago Title & Trust Co.*, 182 U. S. 438, 448. And a change in the law can mean only that the prior laws intended a full exemption of all stock dividends.

It is true, of course, that this rule of construction is not always applicable, if other evidence indicates that the purpose of the change of expression was merely the clarification of existing law. *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 468-469. The Government attempts, by the debates in Congress, (Br. No. 27, p. 20) to prove that such was the purpose of the change in the 1936 Act. We submit that, in fact, the debates, as well as the Act itself, make it abundantly clear that the language of Section 115 (f) was changed in order to remove an existing exemption, not to clarify it.

The Government relies, (Br. No. 27, p. 20) on the statement by Representative Vinson on April 28, 1936 (Cong. Rec., Vol. 80, p. 6309):

> The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder.

Literally, the statement does not support the Government's argument, for it states simply that the law remains unchanged in respect of a stock dividend where there is no change in the proportion of ownership—*i. e.*, where, even under the *Koshland* decision, the stock dividend is constitutionally exempt. The attempt of the Government to torture it into a statement that the law was not changed by the 1936 Act *in any respect* is refuted not only by the context of the particular statement, but also by other remarks by the same Representative.

The full discussion during which the statement relied on by the Government was made is as follows. The italicized portion, which follows that paragraph upon which the Government relies, reveals the true meaning of Representative Vinson's remark (Cong. Rec., Vol. 80, pp. 6309-6310):

> MR. TREADWAY. . . . Now, referring to section (f), taxable stock dividends, which is, of course, entirely

new, that is, the principle is entirely new in that there is a set-up there under which stock dividends can be taxed which has not been in the previous law. I am correct in that?

MR. VINSON OF KENTUCKY. If the gentleman from Massachusetts will permit, under the 1934 act there was a provision that said no stock dividend should be taxed. In a very celebrated case, Eisner against Macomber, the Supreme Court held that the tax dividend involved in that case was not taxable. Out of that case grew up the idea that no stock dividend was taxable. I think it was because of that notion that the language to which I have referred, as appears in the 1934 bill, found its way there; that is, that no stock dividend should be taxed.

The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder.

MR. TREADWAY. The language stricken out, I may say, reads as follows:

> (b) Stock dividends: A stock dividend shall not be subject to tax.

That is the existing law and has been the law most of the time since the Eisner against Macomber decision. In the next tax bill after that decision that language was included.

I understand the gentleman's explanation to be that the language of the act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision.

MR. VINSON OF KENTUCKY. *That is correct.*

MR. TREADWAY. The language now substituted for the stricken language describes new stock dividends that can be taxed or what portion of stock dividends under the sixteenth amendment can in the future be taxed. Is that the right conception of the intention?

MR. VINSON OF KENTUCKY. Well, we take the broad position that stock dividends that are taxable income within the sixteenth amendment are subject to taxa-

> tion, and if there are not such stock dividends and not any taxable income under the sixteenth amendment, they are not subject to taxes.
>
> . . . . . .
>
> MR. TREADWAY. Therefore, the language is drawn with the view of complying with conditions under which the sixteenth amendment is applicable.
>
> MR. VINSON OF KENTUCKY. The gentleman states it in a nutshell. [Italics supplied]

Moreover, there had been a discussion of the new Section 115 (f) on May 27, the previous day. In that discussion Representative Vinson stated, beyond all shadow of doubt, that he understood the 1936 Act to change the prior law (Cong. Rec., Vol. 80, p. 6214):

> MR. VINSON OF KENTUCKY. . . . Coming now to stock dividends, this is a field that has more or less been surrounded with mystery. *Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill.* There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of Eisner versus Macomber.
>
> The kind of securities issued and the change in the proportion of ownership of a person in a corporation are the determining factors as to whether or not it is taxable income under the sixteenth amendment. . . . [Italics supplied]

The Senate likewise understood that the exemption was being narrowed by the 1936 Act. On June 3, after the *Koshland* decision, Mr. Justice Black, then Senator, in discussing the dividends paid credit provision of the 1936 Bill, stated (Cong. Rec., Vol. 80, p. 8811):

> MR. BLACK. . . . As all Senators know, until about two weeks ago it was generally believed that it was impossible to tax stock dividends as income of the recipient of those stock dividends. About two weeks ago, however, the Supreme Court of the United States rendered an opinion which appeared in the Record, in

> which it decided if those stock dividends were declared in a different type of stock than the stock which was originally held by the owner, that those dividends did constitute actual income—taxable income, if you please—in the hands of the stockholder recipient.
>
> That being true, we have provided in such manner as to avoid any possible misunderstanding, that stock dividends declared in such manner that they are taxable in the hands of the recipient will be considered as distributed profits against which no undistributed-profits tax is imposed. . . .

Decisive proof of an intention to change the existing law is furnished finally by the language of the 1936 Act, which, in Section 115 (h), Act of June 22, 1936, c. 690, 49 Stat. 1648, provides:

> The distribution . . . by or on behalf of a corporation of its stock . . . shall not be considered a distribution of earnings or profits of any corporation. . . .
>
> . . . . . .
>
> (2) If the distribution was not subject to tax in the hands of the distributor because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution *or* because *exempt to him under Section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.* [Italics supplied.]

All the evidence, therefore, points irresistibly to the conclusion that Congress intended in 1921 to exempt all stock dividends from income tax. The Government, however, argues that even on this state of facts the exemption should be narrowed to those stock dividends which are constitutionally exempt under the *Koshland* decision. The contention, simply stated, is that Congress, in enacting Section 201 (d) of the 1921 Act, and Section 115 (f) of the 1928 Act, intended to exempt those stock dividends which were constitutionally exempt; that, under a misapprehension of its

power, it made the exemption too wide; but that now, its power having been clarified, only those stock dividends which are now known to be constitutionally exempt are within the statute.

The simple answer to the contention lies in the fact that the Government's theory attempts to impart to the Congress of 1921 information which it did not have, and consequently interprets the statute in the light of later events, rather than in the light of circumstances as they existed, or were assumed to exist, at the time the statute was passed. It may be conceded that if Congress had known in 1921, or 1928, what it knows now, it would have passed the statute in the form of the Revenue Act of 1936 (*supra*, p. 15). This Court, however, has denied many times that a misapprehension by Congress of the facts which form the basis for its legislation justifies a court in engaging in an act of judicial amendment.

A similar situation was considered in *Merritt* v. *Welsh*, 104 U. S. 694. There Congress had classified sugar for import duty on the basis of the place of the sugar in the Dutch standards of color. The Treasury Department, finding that standard unsatisfactory, applied a chemical test. The Court said (p. 700):

> "Perhaps Congress may have acted under a mistaken idea that color would always indicate quality. Perhaps, up to the time that the law was passed, as the process of manufacture had been conducted, color was an approximate, or general, indication of quality. Suppose this to be so, does it derogate from the fact that color was the standard which Congress, with the lights which it had, saw fit to adopt? Does it not tend to fortify that fact? If it be found by experience that the standard is a fallacious one, can the executive department supply the defects of legislation? Congress alone has the authority to levy duties. Its will alone is to be sought."

Platt v. *Union Pacific R. R. Co.*, 99 U. S. 48, involved the scope of a land grant, made 16 years before, designed to

advance the building of the first transcontinental railroad. In answer to an argument similar to that made by the Government in the present case, the Court said (pp. 63-64):

> "There is always a tendency to construe statutes in the light in which they appear when the construction is given. It is easy to be wise after we see the results of experience. We may now think it quite possible the lands could all have been sold before July 1, 1877. The unforeseen success of the enterprise and the unprecedented rush of emigration along the line of the railroad have shed new light upon the value of the grants made to the company. But in endeavoring to ascertain what the Congress of 1862 intended, we must, as far as possible, place ourselves in the light that Congress enjoyed, look at things as they appeared to it, and discover its purpose from the language used in connection with the attending circumstances."

It will be profitable also to consider the following quotation from *County of Schuyler* v. *Thomas*, 98 U. S. 169, 172:

> "These statutes are to be construed as they were intended to be understood when they were passed, twenty years since. The after-wisdom, obtained by unfortunate results, cannot justly be applied in their interpretation. A construction may *now* be sought which will avoid the payment of the debts contracted for building the road. *Then* every inducement was presented to make subscriptions and obtain the money. Little respect would have been paid to the careful legislator or the strict interpreter of the law, who, twenty years ago, had doubted the power of these counties to make the subscription in question."

See also *United States* v. *Smith*, 197 U. S. 386, 392-393; *Illinois Central R. R. Co.* v. *A. Waller & Co.*, 164 F. 358, 360-361 (C. C. W. D. Ky. 1908); *People ex rel. Fyfe* v. *Barnett*, 319 Ill. 403, 408-409; *In re Bergeron*, 220 Mass. 472, 475; *Werner* v. *Hillman Coal & Coke Co.*, 300 Pa. 256, 262.

In the *Merritt* case, for example, the argument made by the Government in this case was equally applicable—Con-

gress intended to graduate the tariff on sugar on the basis of quality; it was, in light of later events, mistaken as to the best way to measure that quality; therefore, the Court should apply the new test to give effect to the intention of Congress. The argument was rejected there, and it should, likewise, be rejected here.

If Congress chose a narrower view of its power than was necessary, the Court should await the will of Congress to expand that power as, indeed, it was manifested in 1936. In 1921 Congress did mean the exemption to apply to all stock dividends, even though such intention may have been unnecessary or unwise. If the legislature intends a statute to apply to a given situation, a court will never substitute its own desire, no matter how misguided the legislature may have been.

The entire life of the provision, "A stock dividend shall not be subject to tax", beginning with its birth out of *Eisner* v. *Macomber* and ending with its death from *Koshland* v. *Helvering,* reveals an unmistakable purpose to exempt all stock dividends from income taxation. Not a single circumstance is at war with this conclusion. Not a single token points in an opposing direction. We can well accept the proposition of Judge Learned Hand, dissenting in the court below, that the true way of finding out what words really mean is "to reinstate the circumstances in which they were uttered and discover how much a reasonable person would have understood them to include." In fact, the reinstatement of those circumstances forms the very foundation of our position.

Both the majority and minority opinions in *Koshland* v. *Helvering,* 298 U. S. 441, sanction the interpretation which we urge. In the former, Mr. Justice Roberts declared (p. 445):

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, *the Treasury gave the decision a broader interpretation which Congress*

followed in the Act of 1921. Soon after the passage of that Act, this court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially different from the former interest. Nevertheless the successive statutes and Treasury regulations respecting taxation of stock dividends remained unaltered." [Italics supplied.]

Mr. Justice Stone and Mr. Justice Cardozo in their dissenting opinion stated (p. 447):

> "Congress did not intend, however, when it refused to tax the newly acquired shares as income *in praesenti* to exclude them from taxation *in futuro* if disposed of at a profit."

We submit, therefore, that effect should be given to the statute according to its terms, and all stock dividends should be declared exempt from income taxes under Section 115 (f) of the Revenue Act of 1928.

Respectfully submitted,

J. Harry Covington,
John Thomas Smith,
Paul E. Shorb,
David Sher.

Washington, D. C.,
October 19, 1937.

SUPREME COURT OF THE UNITED STATES.

No. 29.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Annie M. Pfeiffer. | On Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 6, 1937.]

Mr. Justice Brandeis delivered the opinion of the Court.

This case presents questions of income taxation applicable to stock dividends.

In 1931, Annie M. Pfeiffer, a holder of common stock in William R. Warner Corporation, received as a dividend thereon 6,291¼ shares of its preferred stock. She also received from the corporation in that year $200,000 cash in exchange for 2,000 shares of its preferred stock which she had received as a dividend in 1928. In her income tax return for 1931, she did not include as taxable income either the preferred stock or the $200,000 cash. She did not include the preferred stock received in that year, because she deemed it exempt from taxation under § 115 (f) of the Revenue Act of 1928. She did not include the $200,000 cash as taxable income, because she considered it the proceeds from the sale of a capital asset. But she did include $180,100 thereof as taxable capital gain on the sale, computing the gain in accordance with the then effective Treasury Regulations. And she paid a tax of $22,512.50 on such capital gain.

The Commissioner assessed a deficiency on each item. He determined that the 6,291¼ shares of preferred stock valued at $629,125, were taxable income of 1931, because not exempt under § 115 (f); and that the $200,000 cash were the proceeds of a redemption under § 115 (g), and hence taxable income. He eliminated the taxable capital gain reported and assessed a deficiency on each of the items.

The taxpayer sought a review by the Board of Tax Appeals. It affirmed the Commissioner's determination that the preferred stock

received in 1931 was taxable income; but reversed his determination as to the proceeds of the 2,000 shares, and said:

"The Commissioner held that the redemption of the 2,000 shares in 1931 was at such time and in such manner as to be substantially equivalent to a taxable dividend in 1931, within the meaning of section 115 (g) of the Revenue Act of 1928. He erred in this since the distribution was subject to tax as a dividend in 1928 (see cases above cited). Thereafter the shares had a basis for gain or loss to the petitioner of $100 each, and they were redeemed without gain or loss to the petitioner at $100 each in 1931."

The Commissioner acquiesced in the Board's decision. The taxpayer sought a review by the Circuit Court of Appeals. It reversed the Board's decision as to the 1931 stock dividend, on the ground that § 115 (f) exempted that dividend from taxation; and it affirmed the Board's decision that the $200,000 cash was not taxable income of 1931, saying (88 F. (2d). 3, 5):

"The appellee argues that the proceeds from the redemption in 1931 of 2,000 shares of preferred stock distributed as a stock dividend in 1928 should be considered either (a) subject to a tax as a capital gain or (b) subject to taxation as the equivalent of the distribution of a taxable dividend pursuant to section 115 (g) of the Revenue Act. The question of taxability as capital gain of the $200,000 or any part thereof was not in issue before or decided by the Board of Tax Appeals. The contention that we have authority to sustain the deficiency pro tanto even though the issue was not raised before the Board nor decided by it nor assigned as error in the petition to this court for a review of the Board's decision is untenable. General Utilities & Operating Co. *v.* Helvering, 296 U. S. 200, * *; Helvering *v.* Salvage, 297 U. S. 106, * *. The Board held that this stock dividend redeemed in 1931 at $100 per share was taxable in the year 1928 when received and was therefore not taxable under section 115 (g); that it had a basis for gain or loss of $100 per share; and that therefore there was no taxable income from the redemption. The Commissioner did not file a cross-appeal. By the provisions of section 115 (g) the proceeds of the redemption of the stock can be taxed only if it occurs at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend. Since the Board did not so find, we cannot support this contention."

The Commissioner's petition for certiorari was granted in connection with that in *Helvering* v. *Gowran*, No. 27, decided this day.

First. As to the 1931 dividend in preferred stock, the Commissioner contends that the immunity from taxation conferred by

§ 115 (f) did not extend to it. We hold, for the reasons stated in Paragraph First of *Helvering* v. *Gowran*, that it was exempt from taxation.

Second. As to the $200,000 received in 1931, the Commissioner contends that the Circuit Court of Appeals erred in failing to hold it taxable income, since under the rule declared in *Helvering* v. *Gowran*, the cost was zero.

We are not at liberty to entertain that contention. The Board of Tax Appeals decided that the $200,000 was not taxable income of 1931. As the Commissioner did not seek a review of that decision, which was adverse to him, the Circuit Court of Appeals properly refused to consider the contention. *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206. While a decision below may be sustained, without a cross-appeal, although it was rested upon a wrong ground, see *Helvering* v. *Gowran*, an appellee cannot without a cross-appeal attack a judgment entered below. Compare *United States* v. *American Railway Express Co.*, 265 U. S. 425, 435; *Morley Construction Co.* v. *Maryland Casualty Co.*, 300 U. S. 185.[1] The same rule applies to a decision of the Board of Tax Appeals.

Third. The Commissioner requests that, if we hold that the Board erred in declaring that the 2,000 shares received in 1928 were then taxable and refuse to review its decision that the proceeds received in 1931 were not taxable, we should remand the case to the Board to determine whether redemption of the 2,000 shares was made at such time and in such manner as to be essentially equivalent to the distribution of a taxable dividend under § 115 (g). The Commissioner acquiesced in the decision of the Board. No good reason is shown for disturbing it.

Affirmed.

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[1] See also The Stephan Morgan, 94 U. S. 599; Mount Pleasant v. Beckwith, 100 U. S. 514, 527; United States v. Blackfeather, 155 U. S. 180; Landram v. Jordan, 203 U. S. 56; Southern Pine Lumber Co. v. Ward, 208 U. S. 126, 137; Fitchie v. Brown, 211 U. S. 321, 329; Bothwell v. United States, 254 U. S. 231.

SUPREME COURT OF THE UNITED STATES.

No. 29.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Annie M. Pfeiffer. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 6, 1937.]

Mr. Justice Stone and Mr. Justice Cardozo think the judgment should be reversed.

The issue before the Board of Tax Appeals was the existence of a deficiency in respondent's income tax for a single year, 1931. The deficiency fixed by the commissioner represented her net tax liability for that year and drew in question every item which entered into computation of the tax. *Lewis* v. *Reynolds*, 284 U. S. 281, 283. Her appeal to the board drew in question her net tax liability on a reexamination of every item of income in that year which she had challenged in her petition. The commissioner had treated as taxable income of respondent two items, both received in that year, and assessed a deficiency accordingly. They were a dividend paid to the taxpayer in preferred stock, and cash received by her in that year upon the redemption of preferred stock received as a dividend in an earlier year. The Board of Tax Appeals thought respondent was taxable in 1931 on the first but not on the second item, and reduced the deficiency accordingly. It "Ordered and decided, that there is a deficiency for the year 1931 in the amount of $89,841.75."

This Court, upon consideration of the facts stipulated by the parties and found by the board, holds that respondent was taxable upon the full amount of the item of cash received but not upon the stock dividend. But, because the commissioner took no appeal from the order of the board, the Court declines to give any effect to its ruling that the cash is taxable income in 1931. If the commissioner had sought only to increase the deficiency found by the board, it may be conceded that the point would be well taken, but such is not his purpose. On the contrary, he accepts the order and relies upon

it as establishing a deficiency of which he asks the benefit only so far as it is sustained by the application, to the facts found, of the rule of law announced by this Court.

The circumstance that the board, by the erroneous application of a rule of law to the facts before it arrived at a deficiency which is sustained by a correct application of a different rule, is not ground for setting aside its order. *Langnes* v. *Green*, 282 U. S. 531, 538-539; No. 12, *Anderson, Receiver* v. *Atherton, Administrator*, decided October 18, 1937; compare *Morley Construction Co.* v. *Maryland Casualty Co.*, 300 U. S. 185. In denying to the commissioner any benefit of the order because he did not appeal, the opinion of the Court gives no hint of any ground upon which the commissioner should or could have appealed so far as the order fixes a deficiency which the record shows is lawfully due or why the respondent is not free to maintain that the board reached the right result even though the reason it gave was wrong.

The cause should be remanded to the Board of Tax Appeals to recompute the deficiency in conformity with the rule of tax liability laid down in the opinion of this Court, but in an amount not exceeding that which the board has found.

General Utilities & Operating Co. v. *Helvering*, 296 U. S. 200, does not require any different result. There it was held that it was error for the circuit court of appeals, on an appeal by the commissioner to reverse an order of the board and remand the cause for new findings to support a theory of tax liability which first emerged from the case on appeal. Here there is no new issue to be tried by the board. The only issue is one of law which this Court has resolved and which has been implicit in the case from the beginning.